AMERICAN JEWISH CONGRESS- GENERAL COUNSEL: MASLOW, WILL

TEXACO INCORPORATED, 1988-1990

Hehler 9 EXT. 200

PHONE CALL

FOR Mr. Will Marlow DATE 8/8/88 TIME 3:10 ~~A.M.~~ P.M.

M 1. Canner (CANNER)

OF the Treasury dept

PHONE 202 566 2383
AREA CODE NUMBER EXTENSION

MESSAGE 2386

✓	TELEPHONED
	RETURNED YOUR CALL
✓	PLEASE CALL
	WILL CALL AGAIN
	CAME TO SEE YOU
	WANTS TO SEE YOU

SIGNED

TOPS FORM 4003

Hold until Tuesday Speak to Mr. Marlow about the last number

icals and laboratory equipment. Payment will be by unconfirmed letter of credit deferred for two years.
Bid deadline: August 2 1988.
Contact: Ministry of Defence, Directorate of Contracts and Purchases, Baghdad. Telex: 21-2202 MINDEF IK.

Jordan

Telephone system

Companies have been invited to bid for the supply of a multi-telephone system, with 17 external lines, 16 extensions and one extension for an operator. Each extension will have one local line for communication with other extensions in the telephone system. Local representation is essential.

Jordan recently launched a $330m programme to increase the kingdom's telephone capacity by 219,000 lines. The work, covering 591 towns and villages, will involve the installation of automatic exchanges and of at least 55 new microwave stations, and will include the construction of 100 new buildings to house equipment.
Bid deadline: July 20 1988.
Contact: Central Tenders Board, General Supplies Department, Amman. Telex: 21597.

Morocco

Canal works

Companies have been invited to bid for a contract to execute earthworks along, and resurface, an 18.5 km canal forming part of a major irrigation system. The work will be financed by the Kuwait-based Arab Fund for Economic and Social Development and the Opec Fund for International Development.

In an effort to minimise the impact of frequent droughts, Morocco is working hard to expand the area under irrigation. This year, however, a record harvest is in prospect following excellent rainfall in the winter/spring planting and growing season.
Bid deadline: September 5 1988.
Contact: Bureau des Marches, l'Office Regional de Mise en Valeur Agricole du Haouz (ORMVAH), Marrakech. Telex: 72934.

Railway carriage building

Companies have been invited to bid for a series of contracts relating to a project to build 80 railway carriages. Required are: framework material and doors; copper steel materials; steel and stainless steel materials; steel tubes; MRB tubes; sheet metal, angle irons, aluminium flat bars and tubes; copper and stainless tubes; laminated and stratified materials; and self-adhesive woollen felt bands.

Morocco's railway network comprises 1,779 km of track, of which 1,601 km are single lines and 792 km are electrified. A long-term programme is under way to double the length of track and the numbers of rolling stock and to modernise the existing system. The client, with a staff of 12,000, is one of the biggest employers in the country.
Bid deadline: August 9 1988.
Contact: Direction des Approvisionnements, Office National des Chemins de Fer (ONCF), Rabat-Agdal. Telex: 31669.

Qatar

Aviation training

Bid invitations are in prospect relating to a project to expand facilities at the Doha-based Civil Aviation College for Gulf States. The development stems from a decision last month by Gulf Air, the biggest regional carrier, to provide commercial aviation training at the college.

Gulf Air, owned jointly by Bahrain, Qatar, Abu Dhabi and Oman, recorded revenues of $500m last year and expenditures of $511m.
Contact: Mr Jassim Abdullah al Nisf, Principal, Civil Aviation College for Gulf States, Doha. Teledx: 4135 AVCOLL DH.

Police and fire station construction

Bid invitations are expected to be invited later this year for the construction of the West Bay police and fire station project. The scheme forms part of a project to build three identical stations in Doha.
Contact: David Christer, Resident Manager, John S Bonnington & Partnership (consultants), Doha. Telex: 4745.

Saudi Arabia

Buildings maintenance

Bids have been invited for a three-year contract to maintain the client's office and residential buildings in Jubail Industrial City, on the Gulf coast. Local representation is essential.

The client, charged with the development of Jubail and the industrial city of Yanbu, on the Red Sea, has an allocation of SR 30bn in the kingdom's 1986-90 development plan, of which SR 13.1bn is earmarked for operation and maintenance. Bids were called earlier this year for contracts to maintain other of the client's buildings in Jubail.
Bid deadline: August 31 1988.
Contact: Royal Commission for Jubail and Yanbu, Purchasing and Tenders Department, Jubail. Telex: 832011 JUBI SJ.

Air base operation and maintenance

Companies have been invited to bid for contracts to operate and maintain (A) the King Faisal Northern Air Base and (B) the King Fahd Air Base (in Taif). Local representation is essential.
Bid deadlines: (A) September 17 1988. (B) September 3 1988.
Contact: Ministry of Defence and Aviation, Air Force, Old Airport Road, Jeddah.

Medical supplies, hospital O & M

Companies have been invited to bid for (A) the supply of medicines and chemicals during 1989; and (B) a three year contract to operate, maintain (O & M) and clean the Dammam Central Hospital. Local representation is essential.

Saudi Arabia's 1985-90 development plan allocates SR 62bn to the health sector, of which SR 17bn is for the development of new facilities and SR 36bn for operation and maintenance.
Bid deadlines: (A) and (B) August 6 1988.
Contacts: (A) Tender Department, Ministry of Health, Riyadh. Telex: 401628 HEALTH SJ. (B) Tender department, Directorate of Health, Dammam. Telex: 801180 SJ.

TEXACO July 11 88

Middle East Oil Report

Saudi refining deal may not live up to expectations

Saudi Arabia's plans to take a 50 per cent stake in part of **Texaco**'s refining and marketing network in the US has generally been seen as a shrewd move on the part of a country that is anxious to find a large, guaranteed market for its crude oil. On further inspection, however, the delay may not be quite as impressive as it sounds.

Firstly, Saudi Arabia is unlikely to be able to use anything like the 615,000 b/d refinery capacity that it has acquired from Texaco as a market for its crude oil. Modern refineries are designed to run on a wide range of crudes in order to produce the most profitable slate of refined products at any one time. To maximise their returns, the Saudi-Texaco refineries need to take in more than the limited range of crudes produced by the Saudis. The Port Arthur refinery, for example, currently runs mainly on lighter, lower sulphur crudes than those that are available from Saudi Arabia.

Texaco, in any case, produces some 250,000 b/d of crude oil of its own in the states of Texas and Louisiana, much of which is destined for the Port Arthur and Convent refineries. It seems unlikely that very much of this domestic production would be replaced by increased imports of Saudi crude. Whilst it is true that both the Convent and Delaware refineries have been increasing their runs of Arabian Heavy crude in recent months, supplies of this blend are limited and a good deal of it is more or less committed to the Pascagoula refinery, which is operated by another **Aramco** company, **Chevron**.

Saudi Arabia provides at present some 250-300,000 b/d of crude oil to the three Texaco refineries. In the short term, it looks unlikely to be able to increase this by much more than 100,000 b/d: which, therefore, makes the deal's $800m price tag look quite expensive.

Pricing uncertainty. Moreover, if Saudi Arabia is to supply crude oil on economic terms to the three Texaco plants, it will almost certainly have to be priced in relation to West Texas Intermediate (WTI), the main spot traded crude in the US. Since WTI is also the marker crude for the New York Mercantile exchange's futures contract, Saudi prices may become linked to the world's most volatile oil pricing system: a system once described by Sheikh Yamani as being like a casino. Indeed, pricing Saudi crude in relations to WTI would also make the kingdom's oil revenues subject to the vagaries of the New York market and would certainly sound the death knell for Opec's system of fixed pricing.

Despite such drawbacks, there are a number of other **Opec** countries who show every sign of wanting to follow Saudi Arabia in acquiring overseas refineries. Abu Dhabi's **International Petroleum Investment Company** recently acquired a 10 per cent stake in **Compania Espanola de Petroleos** in a deal that provides for some 60,000 b/d of crude oil to be supplied by Abu Dhabi to the Spanish refiner.

Libya's Oil Investments International Company has recently been negotiating to buy part of **Coastal Corporation's** 90,000 b/d Holburn refinery in West Germany in a further crude oil supply related arrangement. A number of other German refineries, including the former **Mobil** plant at Wilhelmshaven, have also been targeted by Middle Eastern producers for similar deals.

In West Germany, as well as the UK, many voices have been raised against the growing amount of Arab investment in the oil industry. Unless the Saudis can improve on their proposed arrangement with Texaco, the disquiet may soon spread to the producing countries as well.

The deal

Saudi Arabia is to acquire a 50 per cent interest in three of **Texaco's** US refineries along with 49 terminals, a distribution network of over 11,000 service stations and the right to use the Texaco trademark in 23 states. The Saudis will pay $800m for their 50 per cent interest of Texaco's refining and marketing network and will provide 75 per cent of the new joint venture's initial crude oil inventory, worth over $450m at current prices.

The three refineries are:

- Port Arthur, Texas — 250,000 b/d capacity
- Convent, Louisiana — 225,000 b/d capacity
- Delaware City, Delaware — 140,000 b/d capacity

The Saudi interest will be managed by a new subsidiary of **Aramco**, called **Saudi Refining.**

DEPARTMENT OF THE TREASURY
WASHINGTON

B
1988

August 17, 1988

Re: 88-08-30

Dear Mr. Maslow:

We have received your Freedom of Information Act request dated August 3, 1988. You asked for information relating to certain guidelines issued by the Committee on Foreign Investment in the United States.

Every effort will be made to respond by August 31, 1988. If we should need additional time, you will be notified in writing.

Further inquiries concerning this request should make reference to the identification number at the top of this letter and should be directed to:

Freedom of Information Request
Disclosure Program, DO
Room 1054-MT
Department of the Treasury
Washington, DC 20220

Sincerely yours,

Karen Cameron

Karen Cameron
Disclosure Program Manager

Mr. Will Maslow
General Counsel and Editor,
Boycott Report
AMERICAN JEWISH CONGRESS
15 East 84th Street
New York, NY 10028

DEPARTMENT OF THE TREASURY
WASHINGTON

B/Texaco

August 22, 1988

Re: 88-08-30

Dear Mr. Maslow:

This is in response to your Freedom of Information Act Request of August 3, 1988, in which you requested a copy of guidelines and other records concerning the oil and refinery agreement between Texaco, Inc. and Aramco Services, Inc. acting on behalf of the Saudi Arabian government.

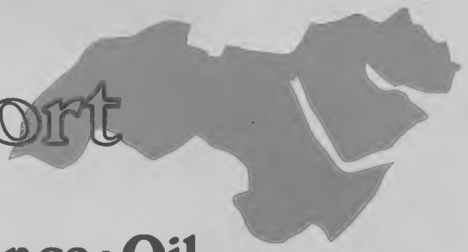
We have conducted a search of the files maintained in this office and no records have been found that are responsive to your request.

Sincerely,

Stephen J. Canner
Director, Office of
International Investment

Mr. Will Maslow
General Counsel and
Editor, Boycott Report
American Jewish Congress
Stephen Wise Congress House
15 East 84th Street
New York, N.Y. 10028

MidEastReport



Politics · Business · Finance · Oil

Volume 21, No. 13
July 1, 1988

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A newsletter reporting events, personalities and issues in the Arab World and the Middle East.
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THE COMMITTEE ON FOREIGN INVESTMENT IN THE U.S. CONSIDERS HOLDING HEARINGS ON TEXACO-SAUDI DEAL

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The Committee on Foreign Investment in the U.S. released on June 20 guidelines to four major government departments in Washington to consider a hearing on the $1.28 billion cash and oil deal between Saudi Arabia and Texaco, a U.S. Treasury Department spokesman revealed to this newsletter.

Four days earlier, Texaco, Inc. and Aramco Services Co. of Houston, Texas, acting on behalf of the Saudi Government, announced they had signed a letter of intent for a joint venture partnership. Aramco's Delaware subsidiary, Saudi Refining, Inc., will have a 50% interest in Texaco's refining and marketing system in 23 eastern and Gulf coast states, and provide 75% of the venture's initial inventory of 30 million barrels of crude, along with its 50% share of net working capital.

The Departments of State, Defense, and Commerce, all members of the inter-agency committee headed by the Treasury Department, may be asked, along with the Energy Department, to consider the effects of the deal if in the Committee's judgment it will have major implications for U.S. national interests. The Council of Economic Advisers and the U.S. Trade Representative Office round off the six-member committee.

If the hearing is convened, the Energy Department may be asked to provide technical input as a non-voting adviser.

Government officials will not surmise when and if the hearing will take place, stating that there are no set guidelines for determining whether the new development should be examined by the Committee.

Meanwhile, the deal is sparking considerable analysis and debate. Oil industry leaders are reportedly expressing reservations that the U.S. may be approaching the point where most of its petroleum is imported from the volatile Middle East.

Other analysts see the Saudi investment in Texaco as a sign that the U.S. is heading for the day when its energy supplies and gasoline prices will once again be controlled by OPEC.

Responding to these issues, Alfred C. DeCrane Jr., chairman of Texaco Inc., said to this newsletter, "I don't dispute the assertion, but that day is further down the road. The time is open for discussion. Certainly, major oil reserves in the world lie in the OPEC states. However, new techniques, greater recovery and the wonders of engineering will open the way for more discoveries."

He continued, "We feel this is a positive step for Texaco and the Saudis, and look forward to sharing the benefits together."

The prevailing attitude is optimistic due to the deal's reciprocal nature. "The more a Middle Eastern crude supplier ties in with a Western economy, the less chance there is of supply disruption to that economy," said Tom F. Rung, Counsel to the House of Representatives Subcommittee on Energy and Power. "But that is not to say there is no possibility of supply disruptions as a result of factors outside of Saudi control," he continued.

Both parties in the venture expect to benefit from the arrangement. Texaco Inc. is anticipating $2 billion in cash benefits and savings based on current oil prices. The Saudis are insuring a safe market outlet for their crude oil.

Moreover, the joint venture is a logical step in the kingdom's continuing program to become more active in the downstream sector of the oil industry.

In fact, Saudi Arabia is following in the footsteps of Venezuela, another OPEC member involved in a joint venture with a major U.S. oil concern. If Venezuela's 1986 arrangement with Citgo is any indication, the Texaco-Saudi deal can expect only advantages. "Citgo's contract for 130,000 b/d of crude oil from Venezuela over a 20-year period has allowed us to stabilize operations at refineries and expand our distributor network," stated Kent M. Young, manager of Public Relations at Citgo, "We also stabilized our earnings in the first quarter of this year with a net income of $41.9 million on revenues of $910 million, our best quarter."

Energy security is more likely to be enhanced for the U.S. than threatened, as exporters make a commitment to supply the U.S. markets. "If anything, the Saudis are in a more vulnerable position in this deal than Texaco," said a State Department official specializing in Middle East affairs. "Texaco

isn't restricted to buying Saudi oil, while the Saudis are committed to supplying it."

"True, we are not restricted to buying only Saudi crude," DeCrane responded, "but as part of the deal, the Saudis will provide 30 million barrels" of crude, worth $480 million at current prices.

Texaco will have the right to purchase up to 600,000 barrels per day (b/d) of crude from Saudi Arabia at prevailing market prices. According to Thomas Q. Shultz, president of Saudi Refining Inc., Texaco will designate a "marker" crude oil and adjust the price it pays Saudi Arabia to the price of the "marker" crude.

The joint venture's assets will include three major Texaco refineries, located in Delaware City, Delaware; Convent, Louisiana, and Port Arthur, Texas, plus 49 terminals and marketing access to over 11,450 gasoline stations. The three Texaco refineries and associated marketing system employ about 4,500 people.

Texaco's long-standing association with Saudi Arabia dates back to the 1930s when it was one of the first companies to prospect for oil in the kingdom.

In his announcement of the deal to the Saudi Press Agency on June 16, Saudi Oil Minister Hisham M. Nazer stated, "The joint venture will provide a stable, long-term outlet for Saudi crude oil in a commercially viable downstream venture in a country with a growing market."

The Texaco-Saudi Arabia partnership will be called Artex, for Arabian Texaco. It is subject to inspection and review of assets, further approval by the Saudi Government and the Texaco board of directors, and the execution of a definitive agreement.

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PLO GETTING A TRICKLE FROM OIL-RICH ARABS FOR *INTIFADA*

OUT OF $400 MILLION IT "DEMANDED" AT ALGIERS ARAB SUMMIT

After regaining most of its influence when the November Arab summit held in Amman, Jordan, snubbed the Palestinian issue, the PLO and its chairman, Yasser Arafat, did not reap all the expected benefits from the uprising at the recently held Arab summit in Algiers, Algeria, from June 7-9.

PLO officials came to the summit asking for financial commitments of $300 million to $400 million a year. Arafat "demanded" a down payment of $129 million (to cover a three-month period) to be followed by monthly installments of $43 million. The PLO stated it needed the money to sustain the strikes in the occupied territories by subsidizing those persons unable to work. No specific amount of money was pledged at the summit.

Although Arab nations are contributing financially to the uprising, it is clearly not what Arafat had in mind. Abu Dhabi, Iraq, Qatar, Kuwait and Libya have donated $14 million for the uprising, mostly for food and medicine. Iraq also pledged when the *intifada* began on December 9 that it would award those Palestinians killed in the riots with the "same generous pensions" it gives the next of kin of Iraqi soldiers killed in the Gulf war with Iran. Jordan has promised similar pension plans while at the same time it continues to pay the salaries of 18,000 civil servants in the West Bank and 6,000 in the Gaza Strip.

At a meeting held in Baghdad in the latter part of June, the PLO's Revolutionary Council, al-Fatah's (Arafat's wing) highest decision-making authority, overcame bitter disputes to set aside $50 million in support of the uprising. The funds were committed by Kuwait and Saudi Arabia and will cover the next six months and will be distributed by the Palestine National Fund, the PLO treasury. Saudi Arabia, by itself, has donated over $11 million thus far.

Members of the Gulf Cooperation Council (GCC), which include Saudi Arabia, Kuwait, the United Arab Emirates (UAE), Oman, Bahrain and Qatar have said because of declining oil prices they want a greater degree of independence in terms of how much, where and to whom the money is being sent. Some GCC members have voiced approval of having the money channelled to international organizations, such as the Red Cross and the United Nations Relief and Works Agency for Palestinian Refugees (UNRWA). This reflects widespread mutual mistrust between the Arab world and the PLO. The Arab world balked at the idea of giving the PLO exclusive control over the monies being generated for the unrest.

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CHRISTIAN LEBANESE FORCES ARE DESTROYING DRUG CULTIVATION

DRUG TRADERS IN LEBANON NETTED $200 MILLION LAST YEAR

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The pro-Phalangist, Christian Lebanese Forces, started an anti-drug campaign in their eastern enclave of the country. After sending several warnings to hashish and poppy planters, traders and consumers, the Forces' Military Police was dispatched to plantation areas to destroy and burn all the harvests.

The destruction and burning operation took place in the Nahr Ibrahim and Zbidin areas, north and east of Beirut, the capital, where heavy tractors were used in the operation.

The Lebanese Forces affirmed there were no hashish-processing laboratories in the eastern part of Lebanon, most of them being in operation in the Bekaa Valley and Zahle, under Syrian military control. Lebanese and foreign drug traffickers are making huge profits from this illicit trade. The Lebanese Forces further said that cultivation of hashish and poppy in the eastern part of the country, under their control, constitutes only 2% of the cultivated areas of the Bekaa, Lebanon's eastern valley.

Lebanon's Agriculture Minister estimated the total value of hashish and poppy production at $76 million last year. However, a recent U.S. Department of State publication, called "Patterns of Global Terrorism," disclosed that opium poppy cultivation in Lebanon reached 27 metric tons (59,508 pounds) in 1987, and annual hashish production is estimated to be at 700 metric tons (1.54 million pounds).

The report (see MER of May 15, 1988, page 6) indicated that an "alarming 20% of Lebanon's gross national product (GNP) comes from the narcotics trade." Lebanon has traditionally been the world's major hashish supplier. The U.S. Department of State Bureau of International Narcotics Matters stated in March that production of opium, heroin, hashish and the newly flourishing trade of cocaine "has netted Lebanon's drug traders with an estimated $200 million a year."

On the other hand, the Bureau of International Narcotics added, while drug cultivation is not official Syrian policy, local commanders serving in Lebanon have accumulated great wealth before being transferred back to Syria. It is thought that Syria's ailing economy is injected with as much as $500 million a year due to drug trafficking.

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The status of 1987's trade balance continues

U.S. HAD TRADE DEFICIT OF $480.5 MILLION

WITH MIDEAST THIS FIRST QUARTER

AMERICAN IMPORTS OF ARAB OIL INCREASING

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The U.S. had a $480.5 million trade deficit with the Middle East and North Africa in the first quarter of this year. According to recent figures compiled by the U.S. Department of Commerce, the U.S. imported $3,803.4 million from the region in the January-March period of 1988, and exported $3,322.9 million to those countries.

This is a reverse in the trend seen in last year's first quarter figures, where exports exceeded imports by $205.8 million.

But the higher volume in exports did not necessarily bode well for the rest of that year, as the initial surplus transformed into a $1,731.1 million deficit by the end of 1987.

Despite the trade deficit in this year's first quarter figures, the Commerce statistics reveal an increase in overall trade activity between the U.S., and the Middle East and North Africa. U.S. import activity was up 44.5%, compared to last year's first quarter import figure of $2,631.4 million. This country's exports increased (in terms of value) to the Middle East and North Africa as well this year, while last year's first quarter exports registered 17% less, or $2,837.2 million.

In addition, the degree of U.S. reliance on imports from the regions under review grew, from 2.7% of U.S. total imports in January-March 1987, to 3.4% this year. The percentage of total exports, on the other hand, diminished from 4.9% last year to 4.4% this year.

Commerce figures are divided into three geographic regions: the Arab Near East, Arab North Africa and the non-Arab Near East comprising Iran and Israel.

To the Arab Near East, made up of Bahrain, Iraq, Syria, Jordan, Kuwait, Lebanon, Oman, North Yemen, Qatar, Saudi Arabia, United Arab Emirates and Yemen Arab Republic, the U.S. sold a total of $1,807.4 million in goods, including re-exports, in the first quarter of this year. This is a 22% increase from

last year's $1,479.5 million in exports during the same period. On the other hand, purchases of goods from the Arab Near East, mainly oil, exceeded sales, giving the U.S. a $1,089.8 million deficit with those countries. The $2,404.2 million in imports was nevertheless an 82.9% increase over last year's first quarter import figure of $1,314.4 million.

In this region, Saudi Arabia was the U.S.'s largest trading partner in the first three months of the year. The U.S. imported $1,792.8 million from the kingdom in the period under review, or 63% more than $1,099.6 million in the previous year. U.S. exports to Saudi also grew, by 22% to $983.7 million from $806.3 million in January-March of 1987.

Increases in trade volume may be attributed to the surge in U.S. purchases of Saudi crude in the first quarter; in February, imports reached 1.2 million barrels per day (b/d).

More than any other country in the Arab Near East, Kuwait's trade activity in imports improved with the U.S., by 686% to $206.1 million in the first quarter of 1988. Imports included mostly crude petroleum, then natural gas, urea and shellfish. This figure compares with $28 million the previous year.

The U.S. registered 37% more in export value to the Gulf sheikdom, with sales of $173.7 million. This was up from 1987's first quarter figure of $126.4 million.

The United Arab Emirates (UAE) was third in the Arab Near East in terms of trade with the U.S. This year's imports from the UAE in the first quarter grew by 219% to $184.4 million, from $57.8 million during the same period of the previous year. The difference in first quarter export figures showed a 49.1% increase, from $124.9 million in 1987 to $186.3 million this year.

Shirt and garment exports to the U.S., for example, are increasing; last year they totaled $5.6 million. Also, coffee, shellfish and computer components from the UAE reached U.S. import tables for the first time in 1987.

War-fatigued Iraq managed to import $230 million of U.S. goods in this year's first quarter, a 115% improvement when compared to last year's U.S. imports of $106.7 million for the same period. Iraq is expected to import more barley this year because of its lower crop prospects. Department of

Agriculture officials project Iraq to buy up to 600,000 tons of U.S. barley in 1988.

Likewise, the U.S. substantially upped its purchases of Iraqi goods in first quarter buying during the periods under review by 87.9%, from $84.5 million to $158.8 million this year.

The U.S. also posted impressive differences in its spending on goods from Bahrain, which increased by 154.2% to $36.1 million in 1988's first quarter from where it stood at $14.2 million in the previous year. Last year, the U.S.'s imports were iron bars, methyl alcohol, unwrought aluminum and crude petroleum.

Conversely, the small Gulf nation diminished its purchases of U.S. goods from last year's $78.2 million by 67%, to $25.8 million in the first quarter of 1988.

Syria and the U.S. went in different directions vis-à-vis trade during the periods surveyed. While first quarter comparisons show Damascus's purchases of U.S. exports went up by 80% to $26.8 million this year, the U.S. has spent 94.3% less than last year on Syrian goods so far, or about $600,000.

The U.S. loosened its pursestrings for Jordan's products in 1988's January-March period, with a $36.1 million import bill that is 154.2% higher than the $14.2 million spent in 1987's first quarter.

On the other hand, the Jordanian market was about 16.2% less receptive to U.S. exports in the first quarter of this year, spending $83.4 million.

The difference in the Arab North African countries' first quarter purchases of U.S. goods this year and in 1987 was negligible. U.S. exports to the region last year totaled $793.2 million and this year were slightly down to $788.9 million. The four countries considered in this category --Morocco, Algeria, Tunisia and Egypt-- were the recipients of 31.5% more revenues from U.S. imports of their products in 1988, or a total of $646.5 million from $491.5 million the previous year. In fact, all four countries posted increases in the values of their sales to the U.S.

Libya, of course, is not included in the survey as all U.S. trade activity with that country ceased last year.

Algeria was the U.S.'s largest trading partner in Arab North Africa, as U.S. imports, mostly of liquid natural gas (LNG), reached $535 million in the first quarter this year. This is a 19.6% increase from last year's total of $417.2 million in the January-March period. The difference between Algeria's purchases of U.S. exports in that period of 1988, and the same period last year is substantial. The U.S. export value of $94 million reaching Algerian markets in 1987's first quarter climbed by 115% to register $202.2 million this year, mostly for agricultural commodities.

Morocco also advanced in trade activity with the U.S. in the first quarter. Imports by the U.S. show a 177.7% difference from last year, or $30 million. U.S. exports to the Alawi Monarchy climbed by 28.6% to $106.8 million in January-March of 1988.

As progress is made to double production at Jorf Lasfar, one of Morocco's phosphate mines, the already substantial $60 million in imports of U.S. sulfur are expected to increase this year.

Egypt was the only country of the four in this region to show a decrease in purchases of U.S. goods. In 1988, the most populous Arab nation restricted its buying by 27% to $421.7 million in the months under review. The U.S., however, shows $70.5 million in first quarter imports from Egypt this year, a 169% increase from the same period's imports last year, which reached $26.2 million.

Export trade is gradually supplanting tourism as Egypt's leading source of foreign exchange. A major challenge is posed this year as slumping production will allow Egypt to fill only half the overseas demand for its cotton.

U.S. import-export values with Tunisia maintained an equilibrium, with increases of about 50% both ways. The U.S. purchased $11 million from Tunisia's markets, in return for $58.2 million in U.S. sales there in the first quarter of this year.

The non-Arab Near East comprises Iran and Israel. Trade with Iran, naturally, is declining. This is particularly noticeable when the 1987 first quarter figures for U.S. imports of $153 million (mostly petroleum) are juxtaposed with this year's $4.3 million, a 97% decrease.

Iran's purchases of U.S. exports were already a low $6.1 million this year from $7.7 million last year; a negligible 20% drop, but the value of trade proves its lessening importance.

U.S. trade with Israel is on an even keel; first quarter comparisons uniformly show increases in export-import activity. U.S. exports to Israel were up by 29% to $720.5 million, while importing $748.2 million in Israeli goods, or 11% more than in last year's first quarter.

It is difficult to ascertain from first quarter figures the direction trade will take in the remainder of the year, Commerce officials say. Sometimes these statistics reflect orders placed the year before. However, the Energy Department predicts a rise in U.S. oil consumption and thus imports in 1988.

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EGYPT IS PAVING THE WAY FOR FOREIGN (ESPECIALLY ARAB) INVESTMENT

U.S. DIRECT INVESTMENT STANDS AT $1.56 BILLION, MOSTLY IN OIL EXPLORATION, BUT ARAB CAPITAL IS STILL LOW AT 18% OF TOTAL

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In a recent report, the American Embassy in Cairo wrote: "The Egyptian Government has undertaken a program of gradual economic reform aimed at increasing investment and enhancing the efficiency of allocation of resources. It has taken steps to devalue the Egyptian pound, reduce impediments to exports, raise prices paid to farmers for sale of their production, reduce the government budget deficit, and improve performance in the public sector."

At the same time, the Government continues to suffer from a lack of foreign exchange revenues that is constraining public sector imports of both consumer and capital goods.

On May 14, the Egyptian authorities increased the price of gasoline by 40% and cigarettes by 20%. Consequently, gasoline will cost the Egyptian motorist 15 cents to 17 cents a liter compared with 11 cents and 13 cents. A packet of cigarettes that cost 28 cents to 35 cents will now cost 34 cents to 40 cents. Be that as it may, the Government hopes to raise $132 million more from new gasoline prices and $88 million more from cigarette increases each year.

The decision came at a time when Cairo has decided to apply some of the recommendations set up by the International Monetary Fund. The IMF could enhance the restructuring of Egypt's $44 billion external debt in extending a $250 million loan. The loan, however, is contingent on the floating of the Egyptian pound which is around LE 2.30 to the U.S. dollar, raising interest rates and reducing budget deficit. The increase in gasoline prices was one of the priorities mandated by the IMF, as well as an equal increase in utilities fares.

Of all those unpopular measures, perhaps the rise in gasoline and cigarette prices may foster unrest in the country. A more expensive gasoline will definitely have an impact on the cost of vegetables and produce. The Egyptians, on the other hand, are known for being "consumed" smokers. And if cigarettes are going to be harder to get, they may very well consider another alternative, perhaps --the *narguileh,* or water pipe.

Anyway, all this huffing and puffing did not prevent the 393 public sector companies from netting $423 million last year, according to official statistics. The year-old free foreign exchange market grossed $3.1 billion or approximately $8.5 million a day; this market is expected to increase trading volumes as the result of returning Egyptians from the oil-rich Gulf countries. Foreign tourists left $2 billion in 1987.

Last year, in fact, was not so bad: Egypt spent $16.75 billion on port and industrial modernization, including $7.4 billion in foreign debt. The industrial sector accounted for $3.58 billion of the total, electricity $2.83 billion, ports $1.56 billion, transportation $3 billion, while agriculture, tourism, air transportation and health received $1.29 billion.

Foreign exchange restrictions, it must be emphasized, will continue to limit imports, particularly by the public sector. Egypt, nevertheless, places a high priority on allocating scarce hard currency to meet basic requirements, such as food, capital goods, building materials and raw materials for industry.

Egypt continues to attract foreign investment, particularly from the Arab world, following restoration of dip-

lomatic ties after the November Arab summit meeting in Amman, Jordan. U.S. direct investment in Egypt now totals nearly $1.56 billion, of which $1.3 billion is in petroleum exploration and $255 million is in manufacturing, banking and other services. During the last two years, nine Egyptian-U.S. joint ventures in manufacturing began production, raising the total number of such investments to 27. The number of Egyptian agents of American companies has increased a measurable 15%, from 428 in 1986 to 492 last year.

Egypt is also doing its best to attract Arab capital, which represents only about 18% of total invested funds. The Cairo Government is speeding up approval procedures of new projects --say from eight months to nearly six weeks. It has, of late, eased investment laws that restricted real estate ownership by non-Egyptians, particularly Arabs.

In mid-April, officials from the United Arab Emirates (UAE), Qatar and Egypt held a round of talks in Doha, the Qatari capital, with the aim of reactivating the Arab Military Production Organization under Egyptian General Ibrahim al-Arabi. The AMPO is a pan-Arab project, founded in 1975 with a $1,040 million capital, and based in Egypt. Eollowing the Camp David Agreements signed by President Anwar el-Sadat, the other Arab partners withdrew in 1979 from the venture. The other Arab partners also included Saudi Arabia, but not Kuwait. Egypt continued alone and has become a major supplier of arms to Iraq.

Perhaps, a positive sign occurred in April also when Arab finance ministers approved Egypt's readmission to four key Arab financial organizations, including the Arab Monetary Fund. With a population of 52 million, Egypt is the Arab world's largest consumer market for Arab investors seeking diversification from falling big equity portfolios, or in industrial and real estate ventures. In this fashion, an Arab investor can go to Egypt to look for his business investment and the pleasure of spending some vacation there.

And if worse comes to worse, setting the clock one hour forward, during the summer months, would save Egypt's energy bill --$58 million a year!

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SILVER LINING FOR MOROCCO'S ECONOMY

RABAT SUCCEEDED IN CURBING INFLATION, GETTING FOREIGN AID, INCREASING EXPORTS, REDUCING CURRENT ACCOUNT DEFICIT AND ATTRACTING TOURISTS

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$17 BILLION FOREIGN DEBT STILL A PROBLEM

The Kingdom of Morocco, in an attempt to get its house in order has come into open conflict with members of the influential business community. In late January, Finance Minister Mohammed Berrada decided to cut the tax holidays enjoyed by investors from 10 years to five years. This infuriated the businessmen, for they argued it was counterproductive to reduce tax holidays while, at the same time, trying to promote exports. The Government of King Hassan II countered that the five-year tax holidays are generous enough when compared to other countries while many of those benefiting industries have little export potential.

At issue is the kingdom's plan to implement International Monetary Fund (IMF) and World Bank-supported reform programs. These include a privatization program, partly financed by a $240 million World Bank loan seen as a vehicle to stimulate a sluggish and over-manned state sector, trade liberalization and a Government development program which attempts to alleviate the problem of a weak infrastructure. Compounding the problem is the bid to do all this while keeping within the confines of the budget ceilings agreed to with the IMF.

Sources contend that the Government is going after the business community because it is an easy target. Because raising funds in Morocco is difficult and tax evasion is prevalent, businessmen have to register with the Government for tax holidays and thus play into the Government's hand. Although an exact figure is not known, analysts suggest the savings will be in the millions of dollars a year.

These savings come at a time when there are encouraging signs about the strength of the economy. Although the fiscal deficit is estimated to be 6.9% of gross domestic product (GDP) in 1987, down 0.2% because of a poor cereal crop, the current account deficit dropped to $23.5 million --the lowest figure since 1974. Also, the inflation rate dropped to 2.8% last last year --the lowest rate for more than a decade. Other fac-

tors include a favorable debt rescheduling which last year brought the debt service ratio down to 25%, compared with 37% in 1986.

According to the Governor of the Central Bank of Morocco, Ahmed Bennani, Morocco can expect economic growth to reach five percent this year. He said Morocco recorded a modest surplus on its current account in 1987 of just over $12 million --the first surplus since the 1970s-- and predicted it would be substantially higher this year but refused to be pinned down.

Bennani, who took the helm of the (Central) Bank al Maghreb in 1985, said the country's balance of trade has also improved significantly. Exports in 1988 would cover over 70% of imports, compared with only 50% in the early 1980s.

Putting a damper on things is the pressing problem of the foreign debt, standing at over $17 billion. However, Bennani stressed in a recent interview that his country was now meeting all its targets for the repayment of foreign loans. In addition, he said, inflation was low and under control at around 4% in 1988, exports were increasing despite tougher competition from overseas and private investment is growing. Bank al Maghreb continues to impose foreign exchange controls but the bank, in last July's annual report, noted that capital outflows exceeded inflows in 1986.

Coinciding with this, one loan by an Arab organization and two trade agreements are instilling much-needed hard currency into the economy. In February, the Arab Monetary Fund (AMF) granted Morocco a $7.9 million loan to offset the deficit in its 1987 balance of payments. The loan, which will be repaid over a three-year period in equal semi-annual installments, carries a low interest rate between 3.75% and 4.75%. This brings the total amount granted to Morocco from the AMF to $92 million or 147.5% of Morocco's share in the Fund's capital.

Also in February, the Jedda-based Islamic Development Bank (IDB) signed an agreement with Morocco stipulating that IDB would finance a foreign trade transaction worth $15 million to import crude oil to the North African Arab nation.

On May 26, Morocco and the European Community (EC) signed three new bilateral agreements to broaden and strengthen their relationship. Among the accords signed is a five-year financial protocol providing Morocco with $400 million in aid. This comes on the heels of the 1987 rejection by the EC to the

Moroccan bid for membership into the Community. Another of those accords signed between the trading partners was a four-year fishing agreement which would allow the EC's fleet to operate off of Moroccan territorial waters for a payment of $58.2 million.

Meanwhile, the Government is continuing its privatization program. Since the dismantling of the citrus and vegetable export monopoly, the Office de Commercialisation et d 'Exportation (OCE), and the formation of a new private company, Atlas Fruit Board, the volume of produce handled has increased by two-thirds while less people are needed to run the operations. Whereas OCE employed 2,000 people, Atlas is producing more with a staff of 60. The export of citrus and vegetables provide Morocco with $2.8 billion --15% of the kingdom's exports.

Few observers believe, however, that the privatization programs will apply to major state corporations such as the phosphate monopoly, Office Chérifien des Phosphates (OCP). With three-quarters of the world's known phosphate reserves, Morocco is the world's largest phosphate exporter while being the third largest phosphate producer --behind the U.S. and the Soviet Union. A planned $1.7 billion expansion program of its production facilities and the development of new bulk cargo facilities at the Port of Jorf Lasfar will likely increase imports of U.S. sulfur as feedstock while also lessening congestion at the Port of Casablanca, Morocco's largest harbor. Morocco already purchases $60 million worth of sulfur a year from the U.S.

Although Morocco's expanded fertilizer market could represent more competition for U.S. manufacturers, it is also thought that the increased Moroccan capacity could result in an expanded net market for U.S. products. Morocco already provides the U.S. with one of its largest favorable balances of trade. In 1987, Morocco imported $526 million worth of U.S. goods while exporting only $34 million to the U.S.

This expansion process will effectively increase the kingdom's exports of raw phosphates, phosphoric acid and fertilizers by 25%. Last year, Morocco exported 12.2 million tons of chemicals. This is out of a total of 22.1 million tons of mined chemicals of which 18 million tons were of sale quality, according to OCP figures.

Nonetheless, the reforms in progress have won Morocco continued assistance from the IMF in the form of a $230 million 18-month standby credit facility which expired in April and is expected to be renewed this month. One problem which may adversely

affect things is the economy's inability to incorporate 250,000 new job-seekers into the economic sector next year.

Complicating matters is the war being waged against the invading army of locusts. Morocco has appealed for $12 million worth of aid from the EC, the U.N. Food and Agriculture Organization and the U.S. This is seen as the worst locust plague since the country gained its independence from being a French Protectorate in 1956. Moroccan officials contend that to win the war against the locusts, they need 570,000 liters of pesticides, 190,000 sprayers, 32 light aircraft and helicopters, two C-130 aircraft and 260 ground vehicles for their expected offensive.

On the political front, however, King Hassan II has scored a major victory with his kingdom's rapprochement with neighboring Algeria. On May 16, the two feuding countries reestablished diplomatic relations after 12 years of bitter political dispute. Relations were severed in 1976 when Algeria began supporting the Polisario Front which was fighting for independence in the mineral-rich Western Sahara. The agreement between Morocco and Algeria called for a "self-determination referendum held with the greatest sincerity and without any constraint."

One reason for the thaw in relations between the two Maghreb nations was the need to show a united front for the Arab summit meeting in Algiers, Algeria, which began on June 7. King Hassan II had indicated he would not participate in the meeting unless diplomatic relations were reestablished. The need for Arab unity has been highlighted in view of the Palestinian uprising in the West Bank and Gaza Strip, which began on December 9.

Since the restoration of diplomatic ties between Morocco and Algeria, Algerians have been reported to be pouring into Morocco on shopping sprees. The Moroccan authorities have welcomed their new visitors by sprucing up their border towns.

Tourism is a very important moneymaker for Morocco, earning nearly $1 billion last year --10% of its foreign revenue, a 20% increase over 1986. The tourism industry employs roughly 200,000 people. However, like most other North African and Middle Eastern nations, tourism in Morocco fell victim to the terrorism scare of two years ago and has still not fully recovered. Morocco attracted 1.6 million tourists in 1987, including 70,000 Americans. In 1986, 1.4 million tourists came to Morocco, including 38,749 Americans. Moroccan officials have embarked on an ambitious five-year-plan to attract 350,000 Americans annually.

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EXECUTIVES IN MIDEAST

--John G. Heimann, 59, vice chairman of Merrill Lynch Capital Markets, has been named chairman of the executive committee of Merrill Lynch/Middle East, the London-based unit. He will remain vice chairman of the U.S. company's capital-markets. Heimann succeeds Stanislas Yassukovich (still non-executive chairman of Merrill Lynch/Middle East) who was last year named chairman of the Securities Association in Britain and deputy chairman of the London Stock Exchange. Heimann, a former U.S. Comptroller of the Currency, will relocate to London from New York.

--Louis D'Amato, 52, was appointed executive vice president-operations division of Bank Leumi Trust Co.'s unit, Bank Leumi Le-Israel in New York. Howard Ross, 45, was named senior vice president in charge of the bank's head office, a new post. Also, Robert Wagner was named first vice president and Michaela Klein was named vice president.

--Ahmed al-Hajj was appointed executive vice president of Bank Almashrek of Beirut, Lebanon.

--Nabil Khairallah was elected to general manager of Banque de l'Industrie et du Tranail of Beirut, Lebanon, succeeding Dr. Sawaya.

--Retired U.S. foreign service officer Robert S. Dillon has been named deputy director-general of the United Nations Relief and Works Agency for Palestinian Refugees, or UNRWA. His last assignment was as American ambassador to Lebanon in 1981-1983.

--R.E. Penn has been elected treasurer of Esso UK beginning the first of this month. He is area manager Middle and Far East in the treasurer's department of Exxon Co. International and succeeds Chris Potter, who will be assigned with Exxon in the U.S.

--John H. Christopherson, senior vice president and treasurer of the Commercial Bank of Kuwait's New York branch, will move to Banco Portugues do Atlantico to head up the treasury department of the Portuguese bank in New York, effective July 5. Christopherson will be replaced at the Commercial Bank of Kuwait by John P. Devine, current vice president and chief foreign exchange trader.

--George Yacoub was elected chairman of the board of Trans-Mediterranean Airways (TMA), the Lebanese cargo company, succeeding Philippe Tabet. Yacoub is an American-educated expert in civil aviation.

--William F. Buchholz was named senior vice president of Camp Dresser & McKee Inc. of Boston, Massachusetts. He is based in Cairo, Egypt.

COMPANIES IN MIDEAST

SAUDI AMENDMENTS

--Philip Holzmann Saudia Ltd.'s capital was decreased to $2,666,666 and redistributed between the two partners: Tareq Abdul Rahman Murad (26.5%) and Philip Holzmann of West Germany (73.5%). Address: P.O. Box 2996, Riyad-11422, Saudi Arabia. Telex: 401311 HLZMRI SJ.

--Reza Investment Co.'s scope of activities and operations was broadened and the capital of $266,666 was redistributed between the two partners as follows: Mustafa Fouad Ali Reza (75%) and Haifa Murad Ali Reza (25%). Address: P.O. Box 18636, Jedda-21425, Saudi Arabia. Telex: 600358 RICO SJ.

--Two of the partners in Saudi Graphco, Olayyan Financing Co. and Khalid Sulaiman al-Olayyan, withdrew from the firm after selling their shares to two new partners, who hold the $4,000,000 capital: Al-Iqtissad Est., owned by Abdullah Ali Salem Bamogaddam (70%) and Said Bamogaddam (30%). Address: P.O. Box 1978, Al-Khobar-31952, Saudi Arabia. Telex: 871450 FINSCO SJ.

--Al-Fadl Contracting & Engineering Co.'s capital was reduced to $533,333 and distributed among the partners: Abdul Aziz Mohammed al-Fadl (50%); Rayyan Abdul Aziz Mohammed al-Fadl (20%); Rakkan Abdul Aziz Mohammed al-Fadl (20%), and Rabia Abdul Aziz Mohammed al-Fadl (10%). Address: P.O. Box 7005, Jedda-21462, Saudi Arabia. Telex: 601650 ALFADL SJ.

--Al-Faris Building Materials Co. Ltd. was converted into a limited partnership to concentrate on building materials, import and export and trade agencies, thereby excluding building contracts and trade in foodstuffs. The capital of $53,333 is held by: Nassir Ibrahim al-Faris (90%) and Badr Nassir al-Faris (10%). Address: P.O. Box 1123, Al-Khobar-31952, Saudi Arabia. Telex: 876242 SJ.

--One of the three Saudi partners in Binladen Telecommunication Co., Saudi Economic & Development Co., withdrew after selling its shares to a new partner, Saleh Salem Ahmed Bin Mahfooz. The capital was increased to $3,466,666 and was redistributed among the three Saudi partners: Binladen Brothers for Contracting and Industry Co. (54.7%); Saleh Salem Ahmed Bin Mahfooz (36.49%), and Hassan Mohammed Shawkat al-Mahassni (8.77%). Address: P.O. Box 6045, Jedda-21442, Saudi Arabia. Telex: 602109 BINTEL SJ.

--One of the two partners in Markaz al-Khaima al-Tijari Ltd., Saudi Economic and Development Co., withdrew from the firm after selling its shares to a new partner, Saleh Salem Ahmed Bin Mahfooz. The capital of $266,666 is held by: Saleh Salem Ahmed Bin Mahfooz and Mohammed Omar Kassim al-Essai (50% each). Address: P.O. Box 8361, Jedda-21482, Saudi Arabia. Telex: 6445659 OKECO SJ.

--One of the partners in Commercial Technical Co., Salem Homood al-Tiraigi, withdrew from the firm after selling his shares to the remaining partners. The capital was reduced to $133,333 and is held by: Sulaiman Homood al-Tiraigi & Bros. Trade and Agriculture Co. (84%); Abdul Hakeem Abdullah Homood al-Tiraigi; Fahd Abdul Mohsin Hamood al-Tiraigi, and Nasser, Sulaiman, Mohammed, Nayef, Khalid and Najeeb, all sons of Hommood Sulaiman al-Tiraigi (2% each). Address: P.O. Box 65, Al-Zulfi-11932, Saudi Arabia. Telex: 305025 TECHNIC SJ.

NEW SAUDI VENTURES

--Fursa Trading Co. engages in wholesale and retail trade in household appliances; household and office furniture and carpeting; building materials; sanitary ware; textiles and ready-made clothes; shoes; rugs; perfumes; cosmetics; computers and other electronic equipment. The firm also organizes exhibitions; auctions for goods and commodities; engages in maintenance of trade centers, and acquires agencies. The capital of $200,000 is held by: Saleh Mustafa Saleh al-Fadl (35%); Ahmed Sulaiman al-Hamad al-Sulaiman (15%); Saud Abdul Aziz al-Abdullah al-Sulaiman (15%), and Best Trading Co. (35%). Address: P.O. Box 5780, Jedda-21432, Saudi Arabia. Telex: 600737 SARAB SJ.

--Nafa Agricultural Co. engages in agricultural and animal production, services, and works; manages agricultural projects and livestock and poultry breeding; engages in wholesale and retail trade in fertilizers, seeds, pesticides, and equipment; manages and maintains gardens, nurseries, and their equipment; manufactures foodstuffs. The capital of $266,666 is held by: Prince Nasser Bin Fahd al-Faisal al-Farhan (20%) and Nafa Enterprises Ltd. (80%). Address: P.O. Box 57976, Riyad-11584, Saudi Arabia. Telex: 400255 SJ.

CORPORATE ACTIVITIES

--According to the chairman of Kuwait Airways, Ahmed Mishari, a consortium formed from 14 Arab air carriers and five financial institutions tentatively agreed to purchase as many as 220 new commercial aircraft at an estimated cost of $10 billion. The new consortium, Arab Aviation Finance Co.'s steering committee will be chaired by Mishari. Aviation sources said that most Arab aircraft purchases will be from Boeing Co. of the U.S. and Airbus Industries, the European consortium.

--The Turkish company, Enka Construction Inc., has received two multimillion-dollar building contracts in Moscow. Enka has signed contracts to build a 1,000-bed hotel and shopping center in Moscow with Soyuzneshstroyimport, the Soviet organization dealing with foreign construction deals. The deal could help pay for Turkey's imports of Soviet natural gas.

--The Saudi Consolidated Electricity Co. for Western Region (SCECO-West) of Saudi Arabia has awarded a contract to Asea Brown Boveri, the Swedish-Swiss firm and Sadelmi Cogepi of Italy for the supply and installation of four 50-megawatt gas turbines for the Rabegh power generation plant at a cost of over $78 million.

--The Israel Corp., the investment holding company controlled by Shaul Eisenberg, the multimillionaire, has reported a near doubling of profits in 1987 from $10.8 million to $19.2 million. The Israel national shipping line, Zim Navigation Co., had much to do with the company's resurgence, in which Israel Corp. has a 45% stake. Israel Corp. also has interest in hotels, high technology industries and the government-controlled refineries. Last year's after-tax profit was the best result for more than five years, and came up from just $15.1 million to $95.3 million. Two-thirds of Israel Corp.'s capital, or $73.1 million, is tied up in oil refineries while there are attempts at deregulation.

--The Export-Import Bank of the United States has helped Scientific Atlanta of Atlanta, Georgia, win a $16 million contract over Japanese, French and Canadian competitors. Eximbank said it will lend $16 million to the Algerian Government to finance Algeria's purchase of telecommunications satellite earth stations and other equipment from the Atlanta-based firm. The 23-year loan will carry an 8% annual interest.

--Lebanese Druze leader Walid Jumblat has formed a company in Beirut called Sea Services Co. The $850,000 capitalized firm will engage in general trade and company participation. Other shareholders include Bahij Rashid Abu Hamza and Badri Ali Ghaith.

--Saudi Arabia's 12th and newest commercial bank, Al-Rajhi Banking and Investment Corp., closed its share flotation at $86 million after being oversubscribed at least five times. Subscriptions of more than $4 million will be held by Al-Rajhi for up to four months while shares are distributed. Of Al-Rajhi's 7.5 million issued shares, at least 4.27 million are being retained for the founding family and employees.

--The United Arab Shipping Co. of Kuwait, the Arab world's largest shipping firm, brought its losses from $32.4 million to $5.4 million last year, outgoing board chairman Khaled Saleh Ammar said in its annual report released Monday, June 20. The key factor, according to Ammar, was the agreement reached with other international shipping agencies to restore shipping fare levels.

--The Iraqi-Jordanian Industrial Co., having an authorized capital of over $25 million, started its first project with the production capacity of 60,000 tons of detergent. The company, based in Baghdad, would cover 50% of the Iraqi market demands while the rest would be covered through private companies in Iraq and Jordan. Fifty-one percent of the company is owned by itself, based upon the decisions from the joint committee representing both countries and the remaining 49% will be submitted for subscription on an equal basis. A new project in Jordan will call for a $20 million insecticides project.

--Egypt is establishing an export insurance company with a paid-up capital of $4.3 million and have access to a further $21.7 million at a low rate of interest from the National Investment Bank. The new company, The Export Guarantee Co. of Egypt, will be separate from but operate in conjunction with the Export Development Bank of Egypt, which will have a 55% shareholding. Other shareholders in the new company include the National Investment Bank with 15%, and three large public sector insurance companies, Misr, el Shark and National, with 10% each. The new company is expected to begin operations this year.

--The Abu Dhabi Investment Authority (ADIA) recently increased its holdings in Total Compagnie Française des Pétroles to 8.5%. Last November, ADIA announced a 5.51% interest in Total CFP. ADIA is expected to raise its stake in the French oil concern to 10% in the weeks to come. Separately, Kuwait just unveiled an $11.5 billion budget for fiscal 1988-1989 which begins July 1. The projected deficit is $4.86 billion. The budget anticipates total revenue of $7.74 billion and total spending $12.6 billion.

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MIDEAST INSIGHT

--A team of Swiss heart specialists are shuttling back and forth every three weeks between Zurich and Tehran to closely monitor the prostate cancer and cardiac condition of Ayatollah Rohallah Khomeini, Iran's spiritual leader. Khomeini, at 86, is in fragile health as befits a man of his age. But persons who have seen him recently insist that the founder of the Islamic Republic is not necessarily dying, although he believes he is.

--There will be a government reshuffle in the Iranian Government soon, and one Cabinet minister expected to go will be Gholamreza Aghazadeh, the Petroleum Minister.

--April Glaspie, director of the Office of Lebanon, Jordan and Syrian Affairs at the State Department in Washington, will be going to Baghdad in August to become U.S. Ambassador to Iraq. By the same token, deputy assistant secretary at the State Department's Bureau of Near Eastern and South Asian Affairs, Brooklyn-born Edward P. Djerejian, will replace current U.S. Ambassador to Syria, William L. Eagleton, at the end of August.

--The Soviets are busy in "housekeeping" their military hardware in the Syrian port of Tartus on the Mediterranean. They were reported to have stored substantial amounts of sophisticated weaponry there. No one knows whether the Soviet presence was meant to be an effort to assist the Syrians or rather to make sure that the Syrians will not use the weapons in an "unwanted" war with Israel.

--Kuwaiti Crown Prince and Prime Minister, Sheik Saad al-Abdullah as-Salem as-Sabah, who was invited by President Reagan to visit Washington last May 12, has rescheduled his official visit for the second week of July.

--Libyan President Muammar al-Khaddafi, has decided to recall his 300-strong force from Lebanon. The Libyan contingent, due to be soon ordered to pull out by Libyan Foreign Minister Jadallah Azouz al-Talhi, is stationed on the upper Metn region in eastern Lebanon, an area controlled by the Lebanese Progressive Socialist Party under Druze chieftain Walid Jumblat.

--Over the last two years, Iran bought nearly $3 billion of military hardware from China. An Iranian delegation went to Beijing two weeks ago to negotiate the purchase of the new M-9, 375-mile range missile which is 20 years more advanced than the Silkworm missile that was rendered ineffective by the U.S. Navy patrolling the Gulf. The M-9s are still in a stage of experimentation in China.

MIDEAST BRIEFS

WASHINGTON: The World Bank is working out the technicalities for water projects in four Middle Eastern countries. A tidal power plant in Turkey is slated for over $200 million; the Taiz Water Resources Development project south of Sanaa in North Yemen will receive about $13 million; South Yemen's al-Moukkala Water Supply Development project may receive $12 million for development of a well field and distribution system, and $30 million is in the works for a water supply and sewage rehabilitation program in Jordan. These plans will be submitted to the World Bank's board for approval, after financing, consulting and other negotiations are ironed out.

WASHINGTON: Brown & Root's joint venture, a unit of Halliburton Co. and Vinnell Corp., received a $183.7 million Air Force contract to operate and maintain Air Force and Army facilities in Turkey.

MUSCAT: Oman issued on June 21 a royal decree setting up its first stock market. The decree set in motion work on creating a market, but it could be a year before trading begins.

AL-KHOBAR: Arab Petroleum Investment Corp.'s (APICORP) investment record shows that profits have reached $409 million, 102 percent more than its paid-up capital. Since 1976, APICORP has financed and managed credits worth $9.58 billion for Arab petroleum and petrochemical projects. The corporation's share in the credits totaled $987 million. There are further plans to invest $620 million in joint Arab ventures, of which $108 million has already been extended.

KUWAIT: The Organization of Arab Petroleum Exporting Countries (OAPEC) said that its members are losing $18 billion annually as a result of the decline in the U.S. dollar.

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PHONE CALL

FOR Mr. Maslow DATE 8/1/88 TIME 4:20 ~~A.M.~~ P.M.

Mr. Dick Goodman

OF

PHONE 202 566 - 8427
AREA CODE NUMBER EXTENSION

MESSAGE

Mr. [illegible] [illegible]

R. 510.

✓	TELEPHONED
	RETURNED YOUR CALL
✓	PLEASE CALL
	WILL CALL AGAIN
	CAME TO SEE YOU
	WANTS TO SEE YOU

SIGNED Julia D.

TOPS FORM 4003

MidEastReport

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A newsletter reporting events, personalities and issues in the Arab World and the Middle East.
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THE COMMITTEE ON FOREIGN INVESTMENT IN THE U.S.
CONSIDERS HOLDING HEARINGS ON TEXACO-SAUDI DEAL

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The Committee on Foreign Investment in the U.S. released on June 20 guidelines to four major government departments in Washington to consider a hearing on the $1.28 billion cash and oil deal between Saudi Arabia and Texaco, a U.S. Treasury Department spokesman revealed to this newsletter.

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Four days earlier, Texaco, Inc. and Aramco Services Co. of Houston, Texas, acting on behalf of the Saudi Government, announced they had signed a letter of intent for a joint venture partnership. Aramco's Delaware subsidiary, Saudi Refining, Inc., will have a 50% interest in Texaco's refining and marketing system in 23 eastern and Gulf coast states, and provide 75% of the venture's initial inventory of 30 million barrels of crude, along with its 50% share of net working capital.

The Departments of State, Defense, and Commerce, all members of the inter-agency committee headed by the Treasury Department, may be asked, along with the Energy Department, to consider the effects of the deal if in the Committee's judgment it will have major implications for U.S. national interests. The Council of Economic Advisers and the U.S. Trade Representative Office round off the six-member committee.

If the hearing is convened, the Energy Department may be asked to provide technical input as a non-voting adviser.

Government officials will not surmise when and if the hearing will take place, stating that there are no set guidelines for determining whether the new development should be examined by the Committee.

Meanwhile, the deal is sparking considerable analysis and debate. Oil industry leaders are reportedly expressing reservations that the U.S. may be approaching the point where most of its petroleum is imported from the volatile Middle East.

Other analysts see the Saudi investment in Texaco as a sign that the U.S. is heading for the day when its energy supplies and gasoline prices will once again be controlled by OPEC.

Responding to these issues, Alfred C. DeCrane Jr., chairman of Texaco Inc., said to this newsletter, "I don't dispute the assertion, but that day is further down the road. The time is open for discussion. Certainly, major oil reserves in the world lie in the OPEC states. However, new techniques, greater recovery and the wonders of engineering will open the way for more discoveries."

He continued, "We feel this is a positive step for Texaco and the Saudis, and look forward to sharing the benefits together."

The prevailing attitude is optimistic due to the deal's reciprocal nature. "The more a Middle Eastern crude supplier ties in with a Western economy, the less chance there is of supply disruption to that economy," said Tom F. Rung, Counsel to the House of Representatives Subcommittee on Energy and Power. "But that is not to say there is no possibility of supply disruptions as a result of factors outside of Saudi control," he continued.

Both parties in the venture expect to benefit from the arrangement. Texaco Inc. is anticipating $2 billion in cash benefits and savings based on current oil prices. The Saudis are insuring a safe market outlet for their crude oil.

Moreover, the joint venture is a logical step in the kingdom's continuing program to become more active in the downstream sector of the oil industry.

In fact, Saudi Arabia is following in the footsteps of Venezuela, another OPEC member involved in a joint venture with a major U.S. oil concern. If Venezuela's 1986 arrangement with Citgo is any indication, the Texaco-Saudi deal can expect only advantages. "Citgo's contract for 130,000 b/d of crude oil from Venezuela over a 20-year period has allowed us to stabilize operations at refineries and expand our distributor network," stated Kent M. Young, manager of Public Relations at Citgo, "We also stabilized our earnings in the first quarter of this year with a net income of $41.9 million on revenues of $910 million, our best quarter."

Energy security is more likely to be enhanced for the U.S. than threatened, as exporters make a commitment to supply the U.S. markets. "If anything, the Saudis are in a more vulnerable position in this deal than Texaco," said a State Department official specializing in Middle East affairs. "Texaco

isn't restricted to buying Saudi oil, while the Saudis are committed to supplying it."

"True, we are not restricted to buying only Saudi crude," DeCrane responded, "but as part of the deal, the Saudis will provide 30 million barrels" of crude, worth $480 million at current prices.

Texaco will have the right to purchase up to 600,000 barrels per day (b/d) of crude from Saudi Arabia at prevailing market prices. According to Thomas Q. Shultz, president of Saudi Refining Inc., Texaco will designate a "marker" crude oil and adjust the price it pays Saudi Arabia to the price of the "marker" crude.

The joint venture's assets will include three major Texaco refineries, located in Delaware City, Delaware; Convent, Louisiana, and Port Arthur, Texas, plus 49 terminals and marketing access to over 11,450 gasoline stations. The three Texaco refineries and associated marketing system employ about 4,500 people.

Texaco's long-standing association with Saudi Arabia dates back to the 1930s when it was one of the first companies to prospect for oil in the kingdom.

In his announcement of the deal to the Saudi Press Agency on June 16, Saudi Oil Minister Hisham M. Nazer stated, "The joint venture will provide a stable, long-term outlet for Saudi crude oil in a commercially viable downstream venture in a country with a growing market."

The Texaco-Saudi Arabia partnership will be called Artex, for Arabian Texaco. It is subject to inspection and review of assets, further approval by the Saudi Government and the Texaco board of directors, and the execution of a definitive agreement.

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COMMITTEE ON FOREIGN INVESTMENT IN U.S.
WILL NOT HOLD DISCUSSIONS ON TEXACO-SAUDI DEAL

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Texaco Inc.'s plan to sell Saudi Arabia a half interest in U.S. marketing properties and refineries will not be reviewed by the Committee on Foreign Investment in the United States. After perusing guidelines released by the Treasury Department last month (see MER of July 1, 1988, page 2), the Committee's members decided there was no reason "to justify even a staff-level discussion" on the case, a Treasury spokesman said.

Officials at the Departments of Energy and Defense who had an interest in the transaction were contacted by Stephen J. Canner, the coordinator of the committee, but neither Department thought a review was necessary.

According to an Energy Department spokesman, Energy Secretary John S. Herrington's view that "the venture is a vote of confidence for the free market economic policy and can improve energy security" underlied the Department's position on the deal.

The multi-agency committee, headed by the Treasury Department, reviews but cannot block foreigners' purchases of American companies. It also determines whether any anti-trust laws or technology export laws might be violated.

Texaco Inc. signed a letter of intent with Saudi Arabia's Aramco Services Co. on June 16 granting Aramco's subsidiary, Saudi Refining Co., a 50% interest in three of Texaco's refineries and its marketing system in 23 eastern and Gulf Coast states.

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KUWAIT INVESTMENT CO. SELLS KIAWAH ISLAND
TO U.S. INVESTORS FOR $105 MILLION

The Kuwait Investment Co. of Kuwait, which is virtually wholly-owned by the Kuwait Government, has sold the struggling 10,000-acre Kiawah Island Resort, which is 21 miles southwest of Charleston in South Carolina, for $105 million. The sale, which was announced June 30, makes it one of the biggest real estate transactions in South Carolina history. A participant in the negotiations commented that the talks went on for 30 hours.

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PETROLEUM

THE PROSPECTS FOR WORLD OIL NEAR TERM, LONGER TERM

A Presentation Before Drexel Burnham Lambert's Recent Second Annual Energy Conference at Houston, Texas

Joel D. Fischer
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March 1988

- Crude prices will be subject to recurrent bouts of downward pressure over the next several years as OPEC confronts its own penchant to overproduce and a continuing increase in non-OPEC supply.
- As Free World supplier of last resort, OPEC must choose among (a) supply management, (b) chaotic markets or (c) a major net thrust into downstream investment.
- If OPEC pursues supply management, it can regain its comfort level of production (20 million B/D) by 1992 and control over real oil prices (at 22 million B/D) by 1995.
- Light crude prices can recover from recent lows toward $19 by year-end as OPEC discipline firms.
- We see prices escalating at 3% per annum (in line with inflation) to 1992, and at 4½% thereafter; the recovery path will be bumpy.
- If OPEC invests downstream on a large scale (by buying into extant facilities), netback pricing would probably supplant fixed pricing; OPEC would probably find it advantageous to pursue a moderate-price strategy, to reinvigorate demand.
- The pressures for consolidation in the oil industry are intensifying.

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THE PROSPECT FOR WORLD OIL NEAR TERM, LONGER TERM

This morning I will be discussing what is going on in the world oil markets now as well as what I see happening 10 and even 15 year ahead.

INTRODUCTION AND SUMMARY

Crude prices are once again under pressure as traders and refiners perceive OPEC discipline to be lax and anticipate still lower prices. Such concern over interim price weakness and OPEC's ability to tighten supply and to firm the markets will recur repeatedly over the next three years, possibly longer, until the incremental barrel of Free World supply is unambiguously an OPEC barrel—earliest, by 1990. My thesis is that OPEC recognizes, however reluctantly, that it will remain the Free World supplier of last resort and that its choices are: (1) supply management, awkward and uneven (for OPEC is not a true cartel); (2) a rapid descent to perhaps $8 crude and subsequent wild gyrations; or (3) downstream investment, to protect or expand market shares.

- OPEC's greatest problem in the years ahead is the continuing increase in non-OPEC production, which can persist to 1992.

- Another major problem is OPEC's penchant to produce above 19 million B/D, a level of supply that will not be required before 1991. OPEC will regain its comfort level of 20 million B/D by 1992—when its weaker members will be operating at capacity, and will lack any incentive to discount—and its control over real oil prices, at 22 million B/D, by 1995. At that time, oil power will reside in the Middle East. OPEC has not been at 22 million B/D on a sustained basis since 1981.

- OPEC can confound our guardedly optimistic price expectations by massive downstream investments in its major markets. We would then see netback pricing replace fixed pricing (or flexible pricing around a reference price) and have to accept volatility as the norm. As a large-scale seller of gasoline and heating oil, OPEC would find it advantageous to pursue a low-price strategy.

- Our controlling conclusion is that light crude prices will test $15 this spring and then recover toward $19 by year-end as OPEC discipline firms. We see prices escalating at 3% per annum to 1992, and at 4½% thereafter. The recovery path will be bumpy.

THE CURRENT SCENE

In a welcome development, OPEC production fell from 19.1 million B/D in December to 17.3 million B/D in January or by 9.5%. The decline was due less to OPEC statesmanship than to pressures from refiners and the Japanese trading houses for price concessions. In early February, production was probably down toward 16.5 million B/D. However, price concessions have been forthcoming—slowly, reluctantly and selectively—to established major customers and with an eye to the geographical diversity of the markets affected—to minimize the damage to the overall structure of prices. The concessions, in the form of market-sensitivepricing, have been offered by nations accepting much of the recent rollback—Saudi Arabia, Iran, Iraq, Kuwait, and Nigeria. Abu Dhabi, voluntarily taking the largest hit in January (450 TB/D), remains a notable holdout. The concessions are probably sufficient to halt the decline in OPEC output and to lift current production to above 17 million B/D. (February production came in at about 17.7 billion B/D, including production for OPEC storage; by early March, Abu Dhabi had resumed discounting.)

With spring only five weeks away, refiners will probably continue to pressure their suppliers for still further concessions. There is no current urgency to lift. A positive dimension, therefore, in the current scene is that the volumes moving in trade remain constrained and the first-quarter stock draw for the Free World can exceed 3 million B/D. This would almost match the stock draw of early 1987 and bring the companies' stocks down to under 70 days supply. A negative dimension to the current scene is that the producers are holding growing volumes in controlled storage and these supplies will eventually be released. The tug-of-war between buyers and sellers will probably extend into the spring, testing OPEC's discipline. (Europe's mild winter and the recovery in OPEC production have probably limited the Free World stock draw to 2.3 million B/D during the first quarter.)

I would not be surprised to see spot prices for the light crudes, now $16 (Brent) to $16.75 (West

Texas Intermediate) approach $15 in the weeks ahead. My controlling bet is that OPEC will remember the lessons of the unfortunate price war of 1985-86 and will defend the $18 reference price by flexible constraints on volumes and by limiting the scope of further price concessions. Given the weakness of the dollar, the $18 reference price is effectively now $15 in major markets outside North America, markets in which OPEC purchases much of its goods and services.

Given the absence of any serious economic setback in the OECD area, I believe that we will see spot prices for the light crudes recover to approximately $18—OPEC's reference price—by mid-year and toward $19 by year-end. OPEC will probably be moving, in its own awkward fashion, to tighten supply once more.

Clearly, Saudi Arabian policy will remain a major concern. The Saudis have been stressing that they will no longer be OPEC's swing producer, that they will not tighten supply in order to accommodate their colleagues in OPEC when they perceive that their colleagues are overproducing. The Saudis thus appear determined to produce at their quota (4.3 million B/D). It is important to recall that the sharp decline in OPEC's January output was borne chiefly by Abu Dhabi, which took a cut of over 400 TB/D, rather than by Saudi Arabia, whose rollback was about 300 TB/D. (Abu Dhabi was down 50% since September, Saudi Arabia only 6%; of course, Abu Dhabi had been sharply above its quota in late 1987.) In my judgment, the Saudis will be prepared to accept below-quota output when they are convinced that other members of OPEC will be sharing the pain.

THE PERSISTING GLUT OF OIL

Unfortunately, bouts of downward pressure on crude prices will assuredly recur over the next several years. My central thesis is that the principal source of this downward pressure is not the recurring excess in stocks above ground—although that excess remains very important for traders' perceptions and expectations—but the excess in Free World developed capacity. This is the surplus that sits beneath the ground. It includes some of the lowest-cost supply in the Free World.

Some magnitudes will be helpful. The Free World surplus eased from a record 15.7 million B/D in 1985 (equivalent to 40.6% of Free World production) to 14.1 million B/D in 1986 (34.8% of Free World output). The surplus shrank as OPEC expanded its market share and oil demand firmed up a bit as oil prices declined. But, in 1987, the surplus grew again, to 15.1 million B/D. That surplus represented 27.3% of Free World developed capacity and was equivalent to almost 35% of Free World production. OPEC operated at 58.4% of capacity, non-OPEC sources at 90.2% of capacity.

A strong build-up in non-OPEC capacity has occurred since 1979, resulting from the heady price expectations of the Seventies and the attending surge in exploration and development spending. Non-OPEC capacity expanded from 19.2 million B/D in 1979 to 25.0 million B/D by 1987. Over that same interval, Free World consumption declined 4 million B/D, from 52.4 million B/D to 48.5 million B/D. (Consumption bottomed at 45.8 million B/D in 1983.) OPEC, as the swing supplier, took the whole hit. Within OPEC, much of the hit was taken by the Middle East producers whose output sank 47% from 1979 to 1987. The resulting unhappiness of these nations was a major cause of the price war of 1985-86. The unhappiness persists into 1988.

The new non-OPEC capacity has been operated at high rates, to satisfy the requirements of both operators and host nations. New crude reserves at non-OPEC frontiers are frequently expensive to locate and develop, but typically low-cost to produce.

THE ONGOING BUILD-UP OF NON-OPEC SUPPLY

The build-up of non-OPEC capacity now underway implies an increase in non-OPEC production that will probably persist into the early Nineties. Little more than a year ago, many observers had anticipated that non-OPEC supply would turn down by the end of 1988 or in 1989. That expectation has now been deferred for several years. This is unwelcome news for OPEC. Projected increments to demand over the next several years will be filled in large part from the non-OPEC increments to supply. Non-OPEC suppliers will continue to frustrate OPEC revenue aspirations.

Why did non-OPEC capacity turn up again last year? A number of factors were at work: expectations of real oil prices holding close to $18

for several years, the remarkable deflation in the cost of drilling and equipping new capacity, technological progress and improved fiscal incentives.

Important new production in North Yemen has now reached 150 TB/D and can reach 200 TB/D by year end; the potential by 1992 is 400 TB/D, possibly higher. We will see increments this year from Canada, Colombia, Egypt, India, Italy, Norway, North Yemen, South Yemen, and Syria. For the present, natural decline in the United States has been slowed by the rapid build-up in the new Endicott field on the North Slope to 115 TB/D. I estimate the net increase in non-OPEC supply in 1988—**net** of natural decline in mature areas—at 400 TB/D.

We had expected non-OPEC production to turn down by the close of 1988 or in early1989, with the downturn led by the United States, the United Kingdom, and Malaysia. It now appears that the downturn will be postponed until 1992. The non-OPEC supply curve will, however, begin to flatten by 1990 when natural decline at the Prudhoe Bay field begins. The projected steepness of that decline, about 10% per annum, is one of OPEC's fondest dreams at this time.

OPEC has enjoyed good news concerning at least one competitor, a Communist bloc supplier. Because of rising internal requirements, China has begun to reduce its exports of crude and products. Chinese exports will probably continue to shrink. I'll return to China in a few minutes.

The shape of the long-run non-OPEC supply curve is a critical factor in the analysis of world oil. Another essential factor for analysis is the shape of the Free World demand curve. Clearly, the secular demand curve is an imprecise concept. My analysis suggests that the demand curve is now slowly rising. At the point in time where the curves of Free World demand and non-OPEC supply intersect, market power will begin to return to OPEC. Until that point, OPEC must stick with supply management, however awkward and vexing that responsibility remains. We cannot count on the oil traders for supply management, however intriguing we find the traders' activity. The analytically unfortunate reality of our two curves—Free World demand and non-OPEC supply—is that their shapes, their height and slopes, are themselves determined by what we are probing for. That is the price of oil.

FREE WORLD DEMAND

My secular projections for demand are based on Free World real economic activity growing at 3% through 2000. That projection encompasses roughly 2.5% for the OECD area and 4.5% for the LDCs. The associated increase in energy demand is 2% per annum. Growth in oil demand is 1% per annum, including 0.7% for the United States. The energy and oil measures posit continuing gains in the efficiency of oil utilization. While 1% growth in oil demand is not a robust prospect, it means a great deal of oil as one goes out relatively few years, given the recent level of consumption. For the current year, I am employing Free World growth in oil demand of only 0.5%, to allow for the recent shocks to the global economy. Free World oil demand is estimated at 48.9 million B/D this year, compared to 48.6 million B/D in 1987. (These estimates were revised on March 15 to 49.0 million B/D for 1988 and 48.5 million B/D for 1987, in light of recent data and improved near-term economic prospects; the indicated growth rate for 1988 is thus 1%.)

We get to 49.6 million B/D by 1990 and 52.1 million B/D by 1995—almost back to where we were in 1979, when demand attained its previous historical peak of 52.4 million B/D. We reach 54.7 million B/D by 2000.

As previously noted, we are probing for the intersection of the Free World demand curve and the non-OPEC supply curve. Both curves are determinates of the price of oil, as well as determinants. If the secular demand curve proves, in fact, to be declining, OPEC's problems can persist until late in the next decade.

OPEC TO REMAIN SUPPLIER OF LAST RESORT

The OPEC nations may hold the bulk of the Free World's remaining recoverable crude reserves (83%) and they represent by far the lowest cost prospective supply. Nevertheless, OPEC will probably remain the supplier of last resort.

A substantial, if not the greater part, of non-OPEC production will be consumed internally in the

nations where it is produced. There are, of course, exceptions such as Norway, which is cooperating with OPEC in production restraint. Norway, like OPEC, produces much more oil than it can consume. The economics of locational advantage cannot be denied. Much of OPEC production is remote from major markets. In the event of a protracted price war, strong political pressures to protect indigenous production will rapidly emerge outside OPEC areas.

There are numerous reasons for non-OPEC nations to encourage the location of indigenous reserves and to protect established production. These include the economic and military security of controlled supply, savings on scarce foreign exchange (or foreign-exchange earnings), support for economic development, employment and the profit motive for state and private enterprise.

Once crude is located and developed, there is a high probability that it will be produced even if initial price expectations are not fulfilled. Colombia is an excellent example, as is incoming production in North Yemen. The generation of revenue and foreign-exchange earnings is a powerful lure for non-OPEC nations, and operators also require cash flow.

The build-up of non-OPEC production against a backdrop of declining consumption in the industrialized nations has appreciably diminished OPEC's share in the international oil trade since 1977. OPEC's undercutting of the historical role of the international oil companies in marketing its output has contributed to this setback. It is not surprising, therefore, that production in the Middle East declined from 22.5 million B/D in 1977 to a low of 10.9 million B/D in 1985. The price war of 1985-86, born of frustration, facilitated a recovery to but 11.8 million B/D in 1986. The Middle East has absorbed the bulk of the reduction in Free World demand for OPEC oil.

OPEC must endure the unhappy role of residual supplier—swing producer for the world—for still another reason. It consumes only a modest proportion of what it produces, about 17.6% in 1987. This reflects such controlling factors as size of population, economic geography and stages of economic development in the member nations.

OPEC'S DILEMMAS AND OPPORTUNITIES

OPEC and the oil markets must accept the unhappy prospect that maintaining relatively stable crude prices (real or nominal) over the next several years, let alone achieving higher prices, will require continued diligent supply management by OPEC.

Revenue-hungry vendors will usually find it difficult to turn away cash customers. OPEC has a penchant for producing over 19 million B/D for months on end, even though the consequences are predictably unpleasant. An optimistic projection of Free World supply-demand balances suggests that the markets will not require 19 million B/D of OPEC crude production on a sustained basis before 1991. Conversely, an early recession in the OECD area (which we deem improbable) would find OPEC confronting the unpalatable task of allocating 16 million B/D of demand among its members.

Oil will remain the swing fuel of the Free World and OPEC will remain its swing supplier. As swing supplier, OPEC must accept the impact of structural, cyclical and seasonal influences upon demand. Within OPEC, that burden will continue to fall upon the Middle East producers. It is within these nations that the bulk of the world's surplus production capacity is located.

OPEC is in a price trap at this critical juncture. Tightening supply to raise prices will encourage new non-OPEC supply, energy-saving technology and fuel substitution, and reinvigorate conservation efforts. Staying with a low-price strategy would appear to be an optimum near-term course. A protracted regime of low prices would:

1. gradually shift the demand curve for oil upward;

2. accelerate the inevitable contraction in non-OPEC supply, thereby reducing the margin of unutilized Free World capacity and speeding the return of "oil power" to OPEC (and, eventually, to the Middle East);

3. increase the political prestige and importance of the oil-exporting nations in the ongoing confrontation between the "haves" and "have-nots";

4. permit the major oil companies, investor-owned or national entities in the exporting nations, to increase their share of the global oil markets;

5. assist the non-oil LDCs in overcoming their infirmities.

Unfortunately, a low-price strategy will inevitably result in some disgruntled members of OPEC being drawn to discounting, in a desperate effort to improve their revenue position. There is no system of transfer payments within OPEC. Members with limited, mature resource bases (e.g., Algeria) will resent the opportunities available to members with large remaining reserves.

OPEC could, of course, carry its cost advantage to an extreme and produce with an eye to its true costs of production. The average total cost of production in the Middle East is probably still under $2 a barrel on a current cost basis. It is probably under $4 in other OPEC areas. Unleashing a new, protracted price war could shut down a great deal of capacity in the United States, Canada, and the North Sea. We had a taste of this in North America in 1985-86, when prices temporarily sank under $10. Oil could resemble copper, a frightening thought for the U.S. oil industry (and investors). OPEC, and its Middle East members in particular, could expand their market share. This goal would probably be accomplished, however, at the cost of a reduction in revenue and wild gyrations in the oil markets. As noted earlier, very low world prices would assuredly invite measures to protect indigenous production in the United States, Canada, the United Kingdom and other non-OPEC producing nations concerned with economic security.

OPEC's optimum strategy would appear to be sticking with supply management until the early Nineties, until the incremental Free World barrel is once again an OPEC barrel. Market realities and OPEC goals suggest subdued price expectations for the near term—a relatively low-price strategy ($16 to $18 nominal) but not so low as to invite a U.S. policy response.

OPEC has another option which I examine later—massive downstream investment to control outlets.

A PRICING SCENARIO FOR WORLD OIL

Over the next several years, the price of oil can move irregularly upward if the markets become gradually more impressed with OPEC production discipline and OPEC develops more confidence in its own ability to manage supply. It would appear sensible for OPEC to manage supply with flexible ceilings and quotas, rather than with rigid constraints. Flexible pricing, rather than fixed prices, would also be in order. OPEC must always look to the market for signals and work with acceptable bands of variation in prices. There is a growing body of literature on such strategy. The price of crude (viewed as OPEC's basket of light crudes) could hover around $18 for several more years, moving within a range of $1.50 to $2 until 1992. By 1992 or 1993, OPEC will regain its comfort level of 20 million B/D. Market forces can then take over the job of propelling the nominal price of oil higher. I am sticking with $18 real as a control price in my projections.

By 1995, OPEC will regain pricing power when market calls for OPEC crude lift its production rate to 22 million B/D or to 78-80% of capacity. At that operating rate, the price leaders in any major capital-intensive industry regain pricing power, which they must exercise prudently. My scenario for **OPEC's reference price** is as follows, in dollars of the day:

1987A	$18.00
1988	18.50
1989	19.00
1990	19.60
1991	20.20
1992	20.80
1995	22.75
2000	28.10

(As of March 15, I revised my 1988 estimate to $17.50 and my 1989 estimate to $18.25.)

The price begins to rise in real terms, at 1½ times the rate of inflation, in 1995. I employ 3% as the secular rate of inflation. By 2000, we are back to $28, where we were at the start of 1986. We could regain $28 sooner if inflation were to quicken or if

OPEC were to surprise us by remarkable new cohesion. The scenario could also be invalidated by a major recession in the OECD area, which could delay the course of price recovery by a year or longer.

WHAT MIGHT GO RIGHT FOR OPEC OVER THE NEXT SEVERAL YEARS?

1. China might become a net importer of crude by the early Nineties. China is now producing 2.7 million B/D and exporting 650 TB/D (to avoid indebtedness). Internal demand, now 2.1 million B/D, is growing at 6-8% per annum. China's production targets—3 million B/D by 1990, 3.5 million B/D by 1995, and 4.0 million B/D by 1990—could prove elusive.

2. Soviet crude exports will probably soon begin to contract. U.S. technology, if available, could however, extend Russia's production plateau and its export potential.

3. A surge in OECD economic activity would be a big help to the LCDs, where oil demand is expanding at 2.3% per annum. Alas, recession must probably come before renewed vigor.

WHAT MIGHT GO WRONG FOR OPEC OVER THE NEXT SEVERAL YEARS?

1. An early recession in the OECD areas could reduce Free World oil demand by up to 1.5 million B/D. This would be a severe problem for OPEC as supplier of last resort.

2. Early peace between Iran and Iraq, with its implications of increased supply, would exacerbate current problems of supply management.

3. Major new discoveries at non-OPEC frontiers would again delay the date when OPEC regains convincing pricing power.

4. The possibility of a collapse of OPEC discipline cannot be ruled out.

OPEC'S DOWNSTREAM THRUST

OPEC's efforts to influence global crude prices would assuredly be transformed by an acceleration of its efforts to protect or expand market share through new downstream investment in its major markets. Such investment may be viewed as a sensible way to ensure volumes, to monetize the values implicit in crude reserves and to confront the competitive threat posed by newcomers to production. I would view an early acceleration of such effort as a bearish reading by OPEC members of the crude markets for years to come. OPEC might see the date for regaining market power continually retreating.

In undertaking major new downstream investments in the oil-importing nations, OPEC would be replacing a recurrent adversarial role by political bridges, based on mutual dependency. It would be overcoming clear negatives to major investments in new export refineries and export petrochemical facilities on its own soil. These negatives are locational disadvantage for end-products and protection of local facilities by the oil-importing nations. However, OPEC would be surrendering an important measure of political power in control over an essential industrial raw material. As a local producer of refined products and petrochemicals, it would also be surrendering pricing power. In the event of renewed tightness in crude supply and a surge in market crude prices, exporters investing downstream might have to forgo otherwise available economic rents because of price controls or excess profits taxes on products. Their ability to profit from an eventual secular rise in real oil prices might also be constrained. The rate of return on production investments has historically been well above that on refining and marketing.

Because of environmental concerns and policies of rationalization in the major industrial nations, downstream investment will probably continue to take the form of purchasing existing facilities rather than constructing new ones. Purchase is typically the cheaper course. OPEC can choose between direct competition with some of its established customers by purchasing entire systems or by purchasing equities in the systems of its customers—for example, the international

majors—and becoming a joint-venture partner. The partnership approach is the more probable path. Venezuela and Kuwait, the major downstream investors to date, have been following a mixed strategy and proceeding unit by unit.

Managing raw material prices while competing directly with one's remaining customers in the product markets will be an increasingly awkward and hazardous undertaking. There is sufficient competition among crude suppliers to make it difficult to practice price discrimination against nonaffiliated refiners. Managing local product prices will be even more difficult. Interfuel competition and protection of local energy sources must also be taken into account. While OPEC is an imperfect cartel, there is no cartel among refiners and marketers.

Should Saudi Arabia and other leading exporters join Venezuela and Kuwait in a major downstream thrust, the price of crude would most likely be established by what products bring. We would be back to netback pricing on a global scale. I doubt whether a system of fixed prices for crude could survive in that environment. Major crude producers would be increasingly concerned with maximizing integrated profits. In the price war of 1985-86, netback formulas were concerned with protecting the downstream margins of third-party buyers. If the exporters' new downstream thrust were to evolve into a battle for product-market share, downstream margins could temporarily vanish. We could see volatility in both the crude and product markets. Kuwait and Venezuela stress that their recent downstream penetration has been orderly and in no sense destabilizing. I am skeptical that such orderliness would long endure if OPEC's downstream penetration were to accelerate. As a seller of refined products, OPEC would probably pursue a relatively low-price strategy to expand demand.

Fortunately or otherwise, the pace of new downstream investments over the next several years is probably going to be relatively subdued because of budgetary constraints within OPEC. On the other hand, we observe that several billion dollars can buy a great deal of hardware. Downstream assets have not commanded lofty prices in recent transfers.

SUMMARY AND CONCLUSION

Instability and downward pressure would appear endemic in world oil prices unless OPEC forcefully pursues supply management. OPEC faces obvious dilemmas in pricing strategy. The ability of these sovereign nations to reach pragmatic compromises should not be denigrated. Clearly, the Middle East nations have begun to dominate the group. If they opt for a low-price strategy, that strategy will be controlling. We may eventually see a fracturing of OPEC, with producers outside the Middle East entering into regional energy relationships. For example, Venezuela and Ecuador might join with Mexico and Canada to forge a new privileged relationship with the United States.

I am a cautious bull on oil prices because I believe that OPEC understands the current limitations upon its economic power even as it prepares for the potential in its command over vast, valuable resources.

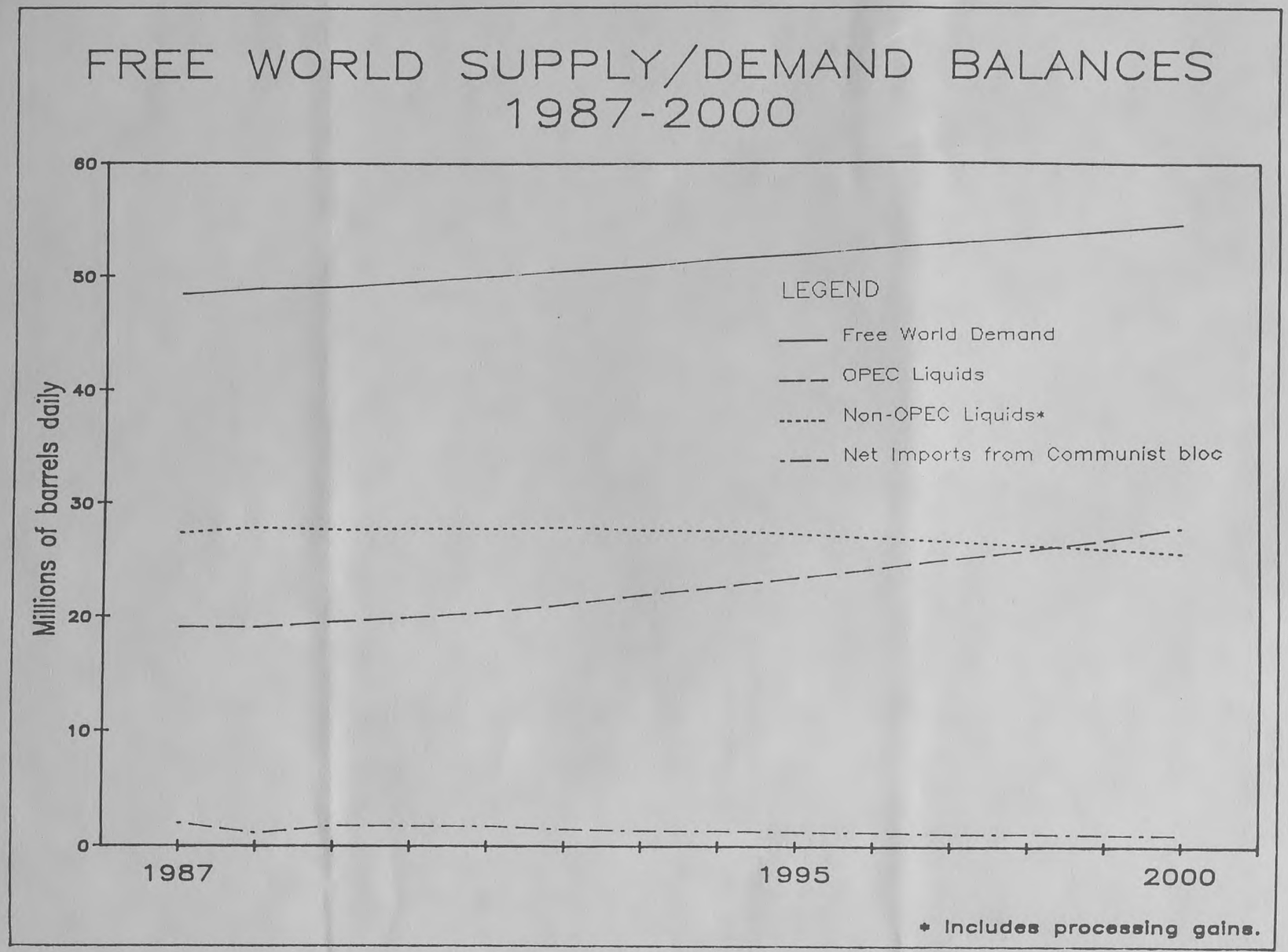
Should OPEC choose to invest downstream in a big way, we would probably soon see a major new restructuring of the world oil business. The pressures for consolidation would intensify. OPEC would probably pursue an overall moderate price strategy as it seeks to expand product demand. Market forces would then supplant OPEC discipline as the dominant influence over crude prices for a protracted period.

PROJECTED FREE WORLD SUPPLY/DEMAND BALANCES, 1988-2000

(Millions of barrels daily)

	1988	1989	1990	1991	1992	1995	2000
Free World Demand	49.0	49.1	49.6	50.1	50.6	52.1	54.7
Free World Supply							
OPEC crude	17.8	18.3	18.7	19.1	19.8	22.1	26.5
OPEC NGL	1.3	1.3	1.3	1.4	1.4	1.5	1.5
Non-OPEC crude	23.3	23.5	23.8	24.0	24.1	23.6	22.0
Non-OPEC NGL	2.8	2.8	2.8	2.8	2.8	2.6	2.6
Net imports from Communist bloc	2.0	1.8	1.7	1.7	1.4	1.2	1.0
Processing gain	1.1	1.1	1.1	1.1	1.1	1.1	1.1
	48.3	48.8	49.4	50.1	50.6	52.1	54.7
Stock change	(0.7)	(0.3)	(0.2)	- -	- -	- -	- -

Source: Drexel Burnham Lambert estimates.


FREE WORLD SUPPLY/DEMAND BALANCES
1987-2000
Millions of barrels daily
60
50
40
30
20
10
0
1987
1995
2000
LEGEND
Free World Demand
OPEC Liquids
Non-OPEC Liquids*
Net Imports from Communist bloc
* Includes processing gains.

INTERVIEW

TEXACO PRESIDENT, JAMES W. KINNEAR:

"NEGOTIATIONS WITH SAUDI ARABIA ARE AT VERY ADVANCED STAGE"

- o -

SAUDIS THINKING OF BUYING HALF OF TEXACO'S U.S. GULF AND EAST COAST'S REFINING AND MARKETING OPERATIONS FOR ABOUT $1.5 MILLION

James W. Kinnear, president and chief executive officer of Texaco Inc. of White Plains, New York, told this newsletter that "negotiations with Saudi Arabia are at a very advanced stage." Saudi Petroleum and Mineral Resources Minister, Hisham M. Nazer, has said in an interview in February that "we are talking to Texaco" for the acquisition of 50% of the American company's extensive Gulf Coast and East Coast refining and marketing operations. A final agreement with Petromin (the Saudi General Petroleum and Mineral Organization) "or a producing country" is expected to be reached "this year," Kinnear disclosed.

Texaco had already talked with Kuwait Petroleum Corp., Royal Dutch/Shell Group and British Petroleum Corp. about setting up joint ventures in Europe. However, as far as Kuwait is concerned, Nader H. Sultan, of Kuwait Petroleum International Ltd., elaborated in January that his country prefers "stand alone investments," meaning outright ownership of foreign refining operations, which the Kuwaitis have accumulated in Scandanavia, the Benelux, France, Italy and other parts of Western Europe.

Kinnear apparently was very happy to state that the relationship between Texaco and Saudi Arabia goes back to 50 years in time. Texaco, along with Exxon Corp., Mobil Corp. and Chevron Corp., are partners with Saudi Arabia in the Arabian American Oil Co. (Aramco). Commenting on the advanced stage of negotiations with the Saudis, the Texaco official said: "I think that's a very, very exciting development. I think we're the first" to have a very big access to the U.S. market. And he is talking to the Saudis and to the Venezuelans. "I think it is a very good thing for both these two countries and the United States" if the deal is concluded, he added.

Kinnear declined, however, to discuss details of the arrangements with Saudi Arabia, but press reports have put the 50% purchase of Texaco's Gulf and East Coast refineries and marketing operations anywhere between $1 billion and $1.5 billion. The refineries in question are at Port Arthur, Texas, the com-

pany's largest, with a capacity of 250,000 barrels a day (b/d); Convent, Louisiana, with a capacity of 225,000 b/d, and Delaware City, Delaware, with a capacity of 140,000 b/d. Texaco also has two refineries in California and one each in Kansas and Washington state with a total capacity of 271,000 b/d. Kinnear said that the sale of half of the United States assets include service stations.

"There will be an oil supply agreement with whoever we do business with," he acknowledged. Texaco is currently importing 250,000 b/d of crude oil from Saudi Arabia, Kinnear said. If the deal is consummated, he added, the Saudis will get half of four marketing divisions which include about 1,500 investment-type services.

About 45 oil companies (including the four Aramco American partners) with refineries had initiated contact with the kingdom about possible joint ventures, over the last year and a half. The Saudis, taking a leaf from the Kuwait Petroleum Corp., are seriously considering investing in the so-called "downstream operations" in Europe and the United States. Texaco, if the arrangement comes to fruition, would operate the facilities, although the Saudis "will have some say" in the management, including, conceivably, a seat on the board of directors.

Now that Texaco's $10.3 billion litigation with Pennzoil Co. of Houston, Texas, is settled with $3 billion in cash, chances are that the "advanced stage" may soon turn into final agreement. The deal, if consummated, would give the Kingdom of Saudi Arabia ample access to U.S. markets all the way to the gas pump for the first time-ever.

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JAMES BALOG IS CHAIRMAN OF LAMBERT BRUSSELS CAPITAL CORP.

James Balog, formerly vice chairman of Drexel Burnham Lambert, Inc., the New York brokerage and investment banking firm, has joined Lambert Brussels Capital Corp. of New York as chairman of the board.

Lambert Brussels Capital Corp. (LBC) provides corporate finance, investment management and advisory services for an international network of affiliated companies. It manages, for example, U.S.-based investments of the Lambert Brussels Associates (LBA) partnership formed by Pargesa Holding SA, a publicly-traded Swiss holding concern; Groupe Bruxelles Lambert SA, the second largest

B
Texaco

Subsidiaries of

The Saudi Arabian Oil Company

and

Texaco Inc.

have formed a joint venture partnership

Star Enterprise

to refine, distribute, and market petroleum products

Morgan Guaranty assisted in the negotiations and acted as financial advisor to Aramco Services Company and Saudi Refining, Inc., subsidiaries of The Saudi Arabian Oil Company

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term it has worsened the trade deficit. Almost two-thirds of the increase in the volume of imports last year was in capital goods, intermediate goods and semi-finished manufactures. The boom was not pure consumer profligacy.

Fine, as far as it goes. But it has so much scope to go further. Each manufacturing worker in Britain still produces roughly a third less than his rival in America, Japan or West Germany. Britain's expanding service businesses have often done even less than declining manufacturing to improve their zip. Although Britain's output of services is almost three times its manufacturing output, recorded exports of services are only half those of manufactures—and in the past 30 years, Britain's share of world trade in services has fallen slightly faster than its share in manufacturing. The output of these service industries is harder to switch abroad. And their inefficiencies handicap the manufacturers that buy services to make their exports.

The British professions—such as lawyers, doctors, teachers and bankers—are riddled with restrictive practices or inefficiencies. Mrs Thatcher has rightly chosen to focus upon improvement here in her third term, but she is meeting an opposition to change that is more wily than the one she was offered by the miners. A testing exchange rate will not lick the service sector into shape. The government's crusade against that (often Tory) opposition will bring forward the day when Britain can confidently return to "go".

Blue-helmet blues

United Nations forces sometimes have to fight to keep the peace. They must be strong enough to do it.

THE United Nations was never intended to police the world. There are some things its peacekeepers simply cannot do. They cannot stop huge armies like those of NATO and the Warsaw pact from clobbering each other if they want to. At the other extreme, they cannot long do the job of a local police force. The UN certainly has a part to play in keeping peace. With the winding-down of two decades' worth of cold-war conflicts in Africa and Asia, that part is getting bigger, and the UN is politically better able to play it. But it must know what it aims to achieve and what will be demanded of it when it sends in its peacekeepers.

Unhappily, this week's bloody fiasco in Namibia suggests that it didn't know these things. It was not the UN's fault that heavily armed SWAPO guerrillas violated the Namibian peace deal in its first hours by crossing the border into the territory (see page 45). But the UN force in Namibia should have been up to handling the affair rather than turn the job over to the South Africans; it would have been able to cope if it had been as strong as originally intended and deployed in good time with a decent plan in its knapsack. The Namibian peace agreement is in jeopardy but will probably survive this setback. There will be no such margin of error for any international force called upon to keep Kampuchea's fiercely warring factions apart when the Vietnamese withdraw their occupying army in September (see page 37).

Stop me before I kill again

Successful peacekeeping requires two things: authority and strength. UN forces always come with at least a dollop of moral authority. Some people argue that this is enough. They say that a weak, non-fighting force can be effective when the combatants want an excuse to stop shooting at each other and are glad to be separated by a symbolic line of bright blue berets. That is fine when it happens; but weakness in the midst of an armed crowd is always risky. In the more usual case, strength as well as authority is called for; but the UN too often shrinks from the hard decision. It votes to set up a force, but keeps it too small and sends it off with orders not to shoot.

The history of the UN's peacekeeping operations shows what can go wrong when timid measures are tried. One of the most ambitious operations was launched in 1960 in the Belgian Congo (as Zaire was then known). In the confusion following Belgium's partial withdrawal from its colony, the UN force was at first given the foolish order not to shoot unless attacked. After losing some men and witnessing some horrific atrocities that it might have prevented by timely action, the force began to jump in to keep the peace. There is little doubt that by going on to the offensive the UN force saved Zaire from being cut in two by civil war. There is no doubt at all that without the peacekeeping force the war would have been worse than it was.

The Congo operation was a half-success. The UN Interim Force in Lebanon has been a complete disaster. Set up in 1978 with the twin missions of keeping Israeli troops out of southern Lebanon and helping the Lebanese government to control the Palestinians there, it was never given the strength to do either. The countries and warlords involved do what they want when they want; and UN soldiers continue to be killed for nothing.

Politicians should think hard before committing a UN force anywhere. But if the decision is made, enough men must be committed to do the job. Peacekeeping forces do not have to be strong enough to overwhelm an army; but they must be something more than score-keepers or targets. They should be burly enough to promise either side a bloody nose.

For that purpose, nice judgments about a force's size are not really needed; but a weak force will usually be worse than useless if the UN's planners and hopers have got it wrong. When in doubt, beef it up—the more powerful the force, the less likely that it will have to fight and the more likely that it will succeed in its mission. The worst answer is to send a clearly inadequate force (which is what happened in Namibia) and then try to keep it safe by ordering it to avoid violence. If armed peacekeeping forces are needed at all, they are needed because they can fight.

B / Texaco

Subsidiaries of

The Saudi Arabian Oil Company

and

Texaco Inc.

have formed a joint venture partnership

Star Enterprise

to refine, distribute, and market petroleum products

Morgan Guaranty assisted in the negotiations and acted as financial advisor to Aramco Services Company and Saudi Refining, Inc., subsidiaries of The Saudi Arabian Oil Company

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Saudis Sign With Texaco for Venture In U.S. in Bid to Become Major Refiner

Texa

By JAMES TANNER
Staff Reporter of THE WALL STREET JOURNAL

LONDON—Saudi Arabia completed arrangements with Texaco Inc. for their big U.S. joint venture and confirmed a goal of becoming a leading oil refiner and marketer world-wide.

"The objective is very simple," said Hisham Nazer, the Saudi oil minister, "and that is to create a very strong (Saudi Arabian) oil industry which is able to stand on its feet and remain there in a highly competitive market."

Mr. Nazer was here for yesterday's signing of the definitive agreement with Texaco for the previously announced U.S. refining and marketing joint venture. The partnership is to be known as Star Enterprise and is expected to be in operation by Dec. 31. According to Texaco, the Saudi participation will provide the company with benefits worth an estimated $1.8 billion. And, for Saudi Arabia, it provides a major stake in oil refining and marketing in the U.S., the world's biggest fuel consumer.

"We will try to get into this type of business all over the world—in Europe and the Far East," Mr. Nazer told a news conference. Asked how much of the oil produced by Saudi Arabia, the world's third largest crude-oil producer, eventually might be processed through such ventures, he replied: "Without putting a time span, probably all of it."

Mr. Nazer called the joint venture with Texaco a big first step in the kingdom's plan to become more actively involved in the refining and marketing segment of the oil industry. Texaco officials here for the signing of the agreement called it a significant development in the company's restructuring program that will produce major cash and other benefits.

The value of the cash benefits previously had been estimated at $2 billion by Texaco. In an interview yesterday, James W. Kinnear, president of Texaco, said the drop in estimated benefits to the company is due entirely to the decline in crude prices since the proposed transaction was announced last June. He said, however, that the terms are the same as previously announced.

The purchase price to Saudi Arabia for the 50% interest in the joint venture is $812 million. In addition, Saudi Refining Inc., which represents the kingdom's interest, will provide 75% of the joint venture's initial oil inventory—some 30 million barrels. Also, the Saudi firm will contribute a 50% share of the working capital other than oil. By sharing inventory and working capital, Texaco expects to realize some $1.8 billion in cash benefits and savings, subject to prices of crude oil and petroleum products at the time of closing.

The agreement provides for the purchase by Saudi Refining of a 50% interest in Texaco's refining assets and marketing system in 23 eastern and Gulf Coast states and the District of Columbia. These include three Texaco refineries, some 1,400 owned and leased service stations and a network of some 10,000 franchised stations.

Star Enterprise, which will have headquarters in Houston, will use the Texaco trademark for its petroleum products in the 23-state area. Also, it will have the right to purchase 600,000 barrels a day of Saudi Arabia's crude oil at market prices.

Officials of both Saudi Arabia and Texaco noted the kingdom and the company have had an association of more than 50 years in the production of petroleum. And their joint venture represents by far the biggest move yet into refining and marketing by a member of the Organization of Petroleum Exporting Countries. The joint venture will rank 10th in total gasoline sales in the U.S.

The document covering the terms of the agreement is more than three inches thick, with pages printed on both sides. Despite its size, development of the joint venture has been speedy. Negotiations between Texaco and the Saudis began only last December.

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4	9.81% — 3	

Kenneth Clark

Civilisation

To Hamlet

U.S. May Review Texaco-Saudi Deal

By Reuters

A committee of the Government's executive branch is considering whether to review the agreement between Texaco Inc. and Saudi Arabia to establish joint refining operations in the United States, the Treasury Department said. The Committee on Foreign Investment in the United States may decide to consider the effect of the deal on American interests, the department said.

Saudi Arabia agreed last month to buy a 50 percent interest in Texaco's refining and marketing system in 23 states for $1.28 billion. It would be the largest acquisition of United States oil operations by a member of the Organization of Petroleum Exporting Countries.

9/30/88

Texa

Texaco Inc., Saudi Venture's Shape Starts to Emerge

By ALLANNA SULLIVAN
Staff Reporter of THE WALL STREET JOURNAL

NEW YORK—The shape of the joint-venture company being created by **Texaco** Inc. and Saudi Arabia is starting to emerge and Texaco officials are hoping the deal can be completed by November.

Texaco and Saudi Arabia have completed a well-defined letter of intent and are in the last stages of executing a final agreement, Texaco officials say.

A six-member board of directors has been set up to run the new company, Texaco Chief Executive Officer James W. Kinnear told an oil industry conference yesterday. He identified the directors as: Glenn Tilton, president of Texaco Refining & Marketing Inc.; Robert Ulrich, Texaco's deputy treasurer; James Shamas, president of Texaco Trading & Transportation Inc.; Hamad A. Juraifani, chairman and chief executive of Saudi Refining Inc.; Thomas Q. Schultz, president of Saudi Refining; and Seth Shar, vice president of Aramco Services Co.

Saudi nationals haven't been included in the management team overseeing operations. But Mr. Kinnear said the position of assistant to Chief Executive Donald Schmude is being held open for a Saudi.

Mr. Kinnear said the company, which hasn't been named, will have its own trading arm which will buy crude oil from Saudi Arabia for its three refineries in "arms length" transactions. Although Saudi Arabia has in the past given preferential treatment to Aramco partners—Texaco, **Mobil** Corp., **Exxon** Corp. and **Chevron** Corp.—Mr. Kinnear ruled out any suggestions that the joint-venture company would receive discounts on the crude it purchases from the Saudis.

Mr. Shultz has previously said the joint-venture company would designate a "marker" crude and adjust the price it pays Saudi Arabia in line with fluctuations in the price of that crude.

Mr. Kinnear said the joint-venture refineries at Port Arthur, Texas, Delaware City, Del., and Convent, La., wouldn't run exclusively on Saudi oil. They import about 70% of the oil they process, much of that from Saudi Arabia. That arrangement would continue, he said. Some of the remaining oil would be acquired through spot, or noncontract, purchases.

In an annoucement last June, Saudi Arabia said it had agreed to participate in the joint venture which has an estimated value of $2 billion for Texaco. Once completed, the transaction will make the kingdom one of the largest gasoline retailers in the Eastern U.S. with access to more than 11,450 gasoline stations.

Although Mr. Kinnear said it was unlikely Texaco would strike any other joint-venture arrangements in the U.S., he wouldn't rule out other such arrangements involving Texaco operations outside the U.S. "But we're not pushing anything else right now," he said. "We have to digest this one."

Speaking separately about the sale of Texaco's 78% stake in Texaco Canada Ltd., Mr. Kinnear said he expected interested buyers to declare their intent within several weeks.

Ashland Oil Plans

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Texaco Deal: A New Saudi Strategy

By MATTHEW L. WALD

News Analysis

By the end of this year, if all goes as planned, the Kingdom of Saudi Arabia will be one of the biggest marketers of gasoline in the eastern United States, in a huge shift from the strategy that has been used by petroleum-exporting countries for more than a decade.

Texaco Inc. and Saudi Arabia announced earlier this month that an affiliate of Aramco, the national oil company, would buy 50 percent of Texaco's distribution and marketing system in the East and Gulf Coast area. The system comprises 3 refineries, 49 terminals, 1,450 service stations owned or leased by the oil company and a distribution network covering 10,000 more stations bearing the Texaco name.

Suddenly the largest member of the Organization of Petroleum Exporting Countries will have more than $1 billion invested in an enterprise that cannot prosper if OPEC sharply restricts the supply of oil, as it has done in the past to raise prices, and leaves refineries idle. And suddenly the Saudis are confronted with having to squeeze out a profit in several unfamiliar parts of the oil business: refining, distributing and retailing.

It also raises the possibility of a kind of gasoline war unseen for many years, extending from the pump all the way back to the well. Such a war would be ignited if enough OPEC members invest in the "downstream" part of the business — refining and marketing — and seek to keep those operations healthy and increase their market share by cutting the price of the crude they supply.

A refinery that got its crude at a

Continued on Page D7

Texaco Deal: New Strategy for the Saudis

Continued From First Business Page

price below what was paid by competitors would have a substantial advantage, and so would a distributor or retailer receiving products below the market price.

But if two members of OPEC, each with a network of refineries, distributors and retailers, began to fight for market share, it could create a cycle of cutting crude prices to hold down the prices of retail products.

That process would run counter to the logic on which OPEC built its success in 1973 and 1979: that the important part of the oil business, the part worth the most money, is taking the crude out of the ground. Saudi Arabia's willingness to invest in the downstream end, some analysts suggest, reflects that country's belief that crude oil supplies will exceed demand for some years to come.

It is probably also a reflection of the Saudis' belief that they must smooth out their oil revenues, which hit $101.8 billion in 1981 but by 1986 had fallen to one-seventh that amount, $17.5 billion. The joint venture with Texaco would help stabilize revenue in several ways. One is by imitating the structure that prevailed when Texaco owned a share of the wells in Saudi Arabia.

"When the major oil companies controlled the market, from production all the way to the consuming end, there was great stability of price," said Emma Brossard, of Brossard Petroleum Consultants, a Houston firm that advises the Venezuelan petroleum industry. Venezuela owns 450,000 barrels a day of capacity in refineries around the world, including half of Citgo's refining and distributing system.

"The producing nations have all realized that for their budgets, as well as for our budgets, there has to be greater stability of price," she said.

Before the producing nations nationalized their wells, the industry was vertically integrated, from wellhead to gas pump. When single entities combined the processes of drilling, transporting, refining and marketing, Ms. Brossard pointed out, "they adjusted their production to the level of demand on the consuming end." By changing the amount of oil pumped from the ground, refined and distributed to service stations, they avoided the shortages and surpluses that push prices up and down, she said.

This "re-integration," or reuniting under one commercial enterprise the separate functions of drilling for oil, refining it and marketing it, can stabilize revenues for another reason, according to oil experts. As has been understood for years by American oil companies, drilling, refining and marketing each run on a boom-and-bust cycle, but the cycles are out of phase, peaking and bottoming at different times.

Philip K. Verleger Jr., a petroleum economist who is a visiting fellow at the Institute of International Economics in Washington, said, "Downstream margins, which include both refining and marketing, are negatively correlated with upstream margins."

For the upstream, or production, end, the dynamics are obvious. Costs of drilling and production are largely independent of the sale price, so profits rise as crude prices go up, and when prices fall the opposite occurs.

But refining and marketing profits generally move in an inverse direction from production profits. When crude prices rise, refiners and distributors are reluctant to raise their prices immediately because of fear of losing their market share, so their profit margins suffer. When oil prices fall, they can usually delay cutting prices, and margins increase.

"This is an extraordinarily intelligent move from a financial point of view," said Mr. Verleger of the Saudi diversification. "They won't make as much during peaks, but they have really shaved the valleys."

J. Robinson West, president of the Petroleum Finance Company, said, "Rather than riding a commodity, the Saudis will recoup earnings all along the petroleum stream, all the way down through marketing and refining."

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OPEC-
Downstream

Oil Change

OPEC Nations Move To Market Gasoline Directly to Consumers

They Want to Extend Role Beyond Producing Fields; Refiners Welcome Step

Retail Prices May Stabilize

By James Tanner 4/24/85

Staff Reporter of The Wall Street Journal

Chances are good that the gasoline you pump into your car is made from OPEC oil. Before long, an OPEC nation may own the filling station, too.

Venezuela already owns half a refinery in Lake Charles, La., that supplies 7-Eleven stores with gasoline, half of another refinery in Corpus Christi, Texas—and wants to buy more. Kuwait has built up a service-station network in Europe under the aptly named Q8 brand and is setting its sights on Asia—and the U.S.

In fact, most of the 13 nations in the Organization of Petroleum Exporting Countries are quietly working to extend their reach from their oil fields to gas pumps in the U.S. and elsewhere. Saudi Arabia is negotiating with Chevron, Exxon, Mobil and Texaco to buy a piece of their refining assets, industry sources say. Abu Dhabi, Ecuador, Libya and the warring nations of Iraq and Iran are on the prowl for refinery stakes in oil-consuming nations. Even cash-strapped Nigeria is close to linking up with one or more U.S. refiners.

Broad Implications

OPEC's reach toward rank-and-file consumers—through the "downstream," or the refining and marketing, segment of the business—holds the broadest implications for global oil markets since the Arab oil embargo 15 years ago. If the pace picks up as quickly as expected, it could raise new political issues in the U.S. and other nations dependent on oil imports. However, consumers will probably benefit as the oil exporters expand their war for global market share to the street corner.

The exporters' strategy would resurrect the oil industry of the 1960s—but this time with OPEC, rather than the Seven Sisters, in control. When the seven giant multinationals controlled most of the world's petroleum from wellhead to gasoline pump, the "upstream" segment, the production of crude oil, was integrated with the downstream sector. But as OPEC members nationalized the oil giants' crude reserves in the 1970s, this vast, integrated industry controlled by a handful of companies became a thing of the past.

But not forever. In the parlance of oil economists, the OPEC nations are seeking to "reintegrate" the industry—this time by linking their oil production operations to the refineries and marketing outlets, which the companies still dominate.

Sales Gains Predicted

The pumping of gasoline, home heating oil and other petroleum products by OPEC members has hardly reached groundswell proportions yet. But some experts predict that this year alone, OPEC members will double their sales of refined products to 27% of all the oil they export.

The degree of their success may determine the future of thousands of traders and speculators. The volatility of oil prices caused by the breakup of the old system gave birth to the New York Mercantile Exchange and an entire industry of spot-market and futures trading. But in the future, OPEC control of both crude-oil and refined-product prices could eventually create a relatively stable price environment, some observers suggest. "If you liked the oil business of the 1960s, you'll love the 1990s," says Antonio M. Szabo, the manager of petroleum planning for Bonner & Moore Marketing Consultants.

Although no one predicts a return to the dirt-cheap fuel prices of 20 years ago, the change "cannot be negative for consumers—only positive or neutral," says John H. Lichtblau, the president of the Petroleum Industry Research Foundation. He and others suggest that fuel prices should be held down because the OPEC nations will bring new competition to the downstream markets and also will run as much crude as possible through any refineries they purchase.

Future Danger

That's if another politically inspired oil crisis doesn't erupt. But Franco Reviglio, the chairman of Ente Nazionale Idrocarburi, sees a possible strategic threat from OPEC's rising clout. Even though the Italian energy company itself is among the refiners discussing joint ventures with "reliable" producing countries, he warns: "The producers already control the upstream. If they control the downstream, too, the next oil shock will be a horrible one."

So far, neither Kuwait nor Venezuela, the pacesetters of the movement, has resorted to gasoline-price wars or other forms of deep discounting. But some refiners nevertheless worry that crude-oil exporters could begin subsidizing their fuel outlets. The front line of any future OPEC battles for market share, such as the price war that triggered the 1986 oil crash, "would be product prices rather than crude prices," predicts the London brokerage firm of Phillips & Drew.

Although OPEC's moves could hurt oil companies and even OPEC itself, the incentives for both sides to link up may be overpowering. Oil is afflicted with a double glut: OPEC has surplus crude production, and refiners have excess capacity. "There's a lot of interest from both sides," says Duke R. Ligon, who helped establish Venezuela's two joint ventures in the U.S.

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Oil Change: OPEC Is Moving to Market Gasoline at Retail

Continued From First Page

as the head of energy mergers and acquisitions at Bankers Trust.

In a world awash with oil, prices of OPEC crude oils have eroded from $40 a barrel in 1981 to the current $14 to $18 range. More important, OPEC's oil output has fallen from 30 million barrels a day in 1979 to fewer than 18 million barrels a day. By grabbing captive outlets in consuming countries, OPEC members win guaranteed customers. And OPEC enjoys a buyers' market for refineries, which are selling at less than replacement value.

"Direct market access has become an overriding necessity for the producers," says Juan Chacin, the president of Petroleos de Venezuela.

On the other side of these transactions, many refiners welcome OPEC partners. Establishing such a partnership is a way to ensure crude supplies at the best possible price. And by selling an interest in excess refining capacity, companies can put assets to fuller use and raise cash as well.

Scores of oil companies in Europe and in the U.S. are proposing to sell equity positions in their refineries, some valued at more than $1 billion, to OPEC countries. Many companies, such as Houston-based Coastal Corp., are negotiating with the national oil companies of OPEC countries. Sun and Crown Central Petroleum confirm holding talks with Nigerian National Petroleum Corp., and industry sources say Arco's Lyondell unit is discussing selling an interest in a Houston refinery.

One U.S. oil company is proposing to buy another refinery to add to its refining facilities and then spin them off to a new unit. The new company, in turn, would be jointly owned with Nigeria, which would swap crude rather than pay cash for its equity share. John P. Venners, a Washington-based negotiator of OPEC oil-supply contracts for U.S. petroleum refiners, is taking a similar approach—as a personal investor. He has established a new company, Prime Oil, to purchase refineries and is seeking a co-owner among the crude producers of Africa and South America.

Long-Sought Goal

Some crude-oil exporters have long harbored ambitions in refining and marketing. In 1972, Sheik Ahmed Zaki Yamani, then the Saudi oil minister, proposed that the kingdom become a "partner" with the U.S. by supplying it with crude and investing in its refineries and service stations. In the 1970s, before the fall of the shah of Iran, National Iranian Oil Co. negotiated to acquire 50% of certain refining and marketing properties of Ashland Oil, but the transaction wasn't completed.

When crude-oil prices were escalating, OPEC had little incentive to move downstream. But now, with both oil prices and OPEC's crude output at low levels, the exporters see a chance to expand markets for their petroleum by going downstream. OPEC's initial inroads into refining have come only in the past five years—largely because of the Venezuelan and Kuwaiti efforts. Their strategies differ. Venezuela wants 50-50 joint ventures; Kuwait prefers full ownership.

Venezuela's national oil company has so far obtained direct outlets for 500,000 barrels a day of its crude exports—equivalent to 21 million gallons—through Ruhr Oel and Nynas Petroleum in Europe and Citgo Petroleum and Champlin Refining in the U.S. "Our target," Mr. Chacin says, "is to increase this participation to some 700,000 barrels a day in the near future." Some of that increase could come from Citgo, co-owned by Southland Corp., which also owns the 7-Eleven chain. Ronald Hall, Citgo's president, says the joint venture would "like to buy another refinery."

The biggest players in Europe—the Kuwaitis—trace their downstream involvement there to a fateful 1981 OPEC meeting when a Gulf Oil official cornered their oil minister to inquire, over a cup of coffee, whether he would like to buy Gulf's European assets for $1.

"That got our attention," recalls Nader H. Sultan, the president of Kuwait Petroleum International.

Lengthy Negotiations

The bargain offer was only for certain assets. But it led to two years of negotiations and Kuwait's eventual acquisition of Gulf's two refineries and more than 3,000 service stations in Europe. That made the cash-rich exporter one of Europe's major purveyors of gasoline and whetted its appetite to move into retailing elsewhere.

So far, Kuwait's downstream operations in Europe account for the marketing of one-fourth of its OPEC crude-production quota of nearly one million barrels a day. Mr. Sultan notes "aggressive expansion plans" to spread the processing and marketing of fuels beyond Europe to the Far East and the U.S. But, he says, "It's getting more difficult to do a deal" because of the rising competition from other producing countries also seeking refineries.

Much of other OPEC members' new enthusiasm for downstream assets overseas has been sparked by the apparent successes of Venezuela and Kuwait. A few months ago, Hisham Nazer, Saudi Arabia's current oil minister, approached Chevron, Exxon, Mobil and Texaco for advice on how the kingdom, which has huge export refineries at home, might go downstream abroad. A follow-up team from Saudi-

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owned Arabian American Oil Co. is collecting the proposals for Mr. Nazer.

Among them, according to industry sources, Mobil offers to sell the Saudis a share of its Naples, Italy, refinery; Exxon proposes an interest in its European refining and marketing operations; and Texaco, trying to sell $5 billion of assets to help it emerge from bankruptcy proceedings, puts a West German and three U.S. refineries on the table. Some 40 other companies also have sent proposals to Mr. Nazer.

Others in Market

In addition, officials of several other crude exporters—including Rilwanu Lukman, Nigeria's oil minister and OPEC's president—say they intend to acquire shares of overseas refineries. Several non-OPEC producers—including Cameroon, Colombia and Mexico, which has a refining stake in Spain—are in the market, too.

Oil experts suggest that the downstream push not only will affect global oil markets but could change the composition of OPEC as well. "Those with refining and marketing assets will find their interests and priorities diverging from the rest of OPEC," says Petroleum Finance Co. in a recent report. And outside OPEC, it could cause political repercussions, including a U.S. debate over national security.

"The prospect of giant integrated companies which could, in a future crisis, be responsive to governments injects an unprecedented political dimension into oil supplies," says Melvin A. Conant, a Washington consultant on the Mideast. "What are the foreign interests of that government? Are they compatible with those of the consumer?"

But many say OPEC's downstream investing should discourage political cutoffs of supplies. "It tends to enhance the energy security of the consumers," says Philip K. Verleger Jr., a visiting fellow at the Institute for International Economics. And industry officials say refining links with OPEC countries should serve national-security interests better than rising imports of petroleum products from foreign-owned refineries. It's a "win-win" situation, says James W. Kinnear, Texaco's president, who expects to sell refining interests to Saudi Arabia within a year.

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6/16/88

Texaco, Saudis Expected to Announce Agreement on Joint Ventures in U.S.

By Allanna Sullivan
Staff Reporter of The Wall Street Journal

NEW YORK—Texaco Inc. is expected to announce in the next few days that it has reached an agreement with Saudi Arabia to set up joint ventures for certain of its U.S. refining and marketing operations, sources close to Texaco said.

Separately, dissident shareholder Carl C. Icahn promised to distribute $300 million to Texaco shareholders should they approve his proposal to buy the company and he fail to get financing.

The Texaco-Saudi announcement would likely be of an agreement in principle, with completion of the transaction subject to some fine-tuning. An individual with knowledge of the negotiations said that the two parties are close to an agreement on the basic economic terms of a transaction, including price.

The price range currently under consideration is between $1.25 billion and $1.75 billion, the same individual said.

Although preparations to make the announcement are already under way, one Texaco executive cautioned that until the deal is done, the agreement could fall apart. As of late yesterday, there was constant communication between Texaco's White Plains, N.Y., headquarters and Saudi officials in Riyadh.

Texaco and the Saudis have been negotiating for months an agreement to set up joint ventures for two and possibly three refineries—Port Arthur, Texas; Convent, La.; and Delaware City, Del. The Venezuelans have also been interested in acquiring the Delaware City refinery. The package would also include certain U.S. marketing areas.

Texaco management's proxy battle with Mr. Icahn has slowed negotiations, but with that vote only one week away, the Saudis may be persuaded to enter into a tentative agreement because it could be overturned if control of the company changes hands.

Earlier this week, Texaco completed the first step of its restructuring program when it sold Deutsche Texaco AG to a West German utility for $1.23 billion.

Mr. Icahn said he will increase his financing guarantee to $300 million and make it payable directly to shareholders. The guarantee would provide $1.50 a share to all Texaco shareholders of record April 11.

Previously, Mr. Icahn had said that he would put up a $100 million guarantee that he would forfeit if he was unable to finance his offer to take over Texaco for $60 a share. That offer would have been paid into the Texaco treasury rather than to shareholders. Wednesday night Mr. Icahn said he was considering increasing his guarantee to $200 million.

Mr. Icahn's new guarantee would be subject to the same terms as the previous pledge. If the Internal Revenue Service fails to give the consent required to enact the investor's financing plan or a third party makes a bid for Texaco for more than $60 a share, he wouldn't have to pay the guarantee.

"The IRS is unlikely to approve a financing plan that would further leverage up the company as Mr. Icahn's plan surely would," said one Texaco adviser. "Therefore his $300 million isn't a real guarantee because he'll probably never have to pay it."

Officially, Texaco responded to Mr. Icahn's "'so-called guarantee" by saying that "nothing is what he's offering Texaco shareholders . . . he has attached such a jungle of strings, conditions and red tape, we are convinced he will never have to put up a dime."

Mr. Icahn has said that he is in serious negotiations with a partner who would share in a financing arrangement. However, he has also said that any such agreement—if it occurs—would be unlikely before Texaco's June 17 annual meeting.

Mr. Icahn also said that if he wins the proxy fight and is elected to the Texaco board, he would consider launching a hostile tender offer for the company if the board continues to refuse to allow shareholders to vote on his present acquisition offer. To do this, he would start an acquisition company by selling debt and equity to raise funds. A source in Mr. Icahn's camp said the investor would put his "considera-

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OPEC Ministers

From Dow

Texaco, Saudi Arabia Likely to Announce Joint-Venture Accord

Continued From Page 3

ble holdings" of Trans World Airline and ACF Corp. stock into the acquisition company, plus $3 billion to $4 billion he expects to raise through the debt and equity offering. He would borrow against those funds to finance the hostile offer.

Separately, the New York Times is expected to press the federal court handling Texaco's suit against Mr. Icahn to allow public access to numerous depositions that have been obtained as part of the discovery process undertaken by Texaco and Mr. Icahn.

Among other things, Texaco has been trying to show that Mr. Icahn has coordinated his trading with other investors. Texaco advisers have questioned officials at Bear, Stearns & Co. as well as T. Boone Pickens Jr. in efforts to prove a trading link.

In a letter, Texaco attorneys have already given the court permission to release the documents, which are currently unavailable because of a confidentiality agreement. The federal judge handling the case has asked the New York Times to show cause at a hearing scheduled for this morning.

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Saudi Deal For Part Of Texaco

50% Stake to Be Sold In U.S. Operations To OPEC Member

8/17/88

By MATTHEW L. WALD

In what would be the largest acquisition of United States oil operations by an OPEC member, Saudi Arabia has agreed to buy a 50 percent interest in Texaco Inc.'s refining and marketing system in 23 Eastern and Gulf Coast states for $1.28 billion in cash and oil, Texaco and Saudi Arabia announced yesterday.

The deal was announced on the eve of the climax of the proxy battle between Texaco and Carl C. Icahn, the financier who is trying to buy the company for $60 a share. Mr. Icahn is seeking to elect himself and four associates to Texaco's 14-member board. Shareholders will decide the outcome at the company's annual meeting today. A victory would help Mr. Icahn in his fight to overcome management's refusal to put his takeover offer to a shareholder vote.

It is not clear whether a victory by Mr. Icahn would disrupt the deal with the Saudis. The agreement is not contingent on a management victory. However, the letter of intent signed by the Saudis gives them 90 days to examine the operations involved and cancel the deal.

Questions of Energy Security

The deal calls for the Saudi-owned Arabian-American Oil Company, known as Aramco, to pay $800 million plus a one-time delivery of 30 million barrels of oil, worth about $480 million at current prices.

The deal, which was signed on Wednesday night, seems certain to spark a major debate in the United States about its effect on energy security and potential impact on the country's Middle East policies. But the Secretary of Energy and international oil experts said the United States would benefit from the deal.

"It is less likely that a producing government will cut off the flow of oil to its refineries," John Herrington, the Secretary of Energy, said in a statement. He noted that the arrangement would give the Texaco refineries access to approximately four billion barrels of Saudi reserves for the 20-year duration of the contract.

Vahan Zanoyan, an analyst at the Petroleum Finance Company, said, "If you're worried about supply disruption, like the kind of things we have had in the last two decades in the Middle East, what's better than giving these guys a stake in the oil industry in the United States?"

'Customers Matter'

Daniel Yergin, president of Cambridge Energy Research Associates, a consulting firm, added: "The Saudis are saying, 'Customers matter; we want to be sure that we have customers.' "

The Saudi-Texaco deal is subject to approval by the United States and Saudi Governments, as well as the Texaco board, the announcement said. The two sides said they hoped the deal would be completed by the end of the year.

Venezuela, another member of the

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Saudis to Buy Into Texaco Operations

Continued From First Business Page

Organization of Petroleum Exporting Countries, is already a major refiner and distributor in the United States through its 50 percent ownership of Citgo, acquired in 1986.

Securities analysts had expected the Saudi-Texaco venture, which has been under negotiations for months. In recent days, there had been rumors that an announcement was imminent. The news did not have a noticeable impact on Texaco's stock, which fell 37.5 cents, closing at $49.50 on the New York Stock Exchange.

In interviews yesterday, some analysts said the deal was a good one for Texaco. "You might use terms like 'brilliant stroke,' because they are the first of the major oil companies to do a deal with the Saudis," said William L. Randol, an analyst with the First Boston Corporation. "It's the wave of the future," he said.

$2,600-a-Barrel Deal

The three refineries — at Delaware City, Del., Convent, La., and Port Arthur, Tex. — have a combined capacity of 615,000 barrels per day, he said, and at $800 million — just the cash portion of the deal — the price comes to $2,600 per barrel of refinery capacity, compared with previous sales in the range of $1,200 to $2,000.

Analysts noted that the deal is also important to Texaco because it gives the company a much-needed assured supply of oil. They said that Texaco's refineries use more oil than the company produces and that its oil reserves have been declining more rapidly than those of most other major oil companies.

Texaco has long ties with Saudi Arabia. It was one of the founders of Aramco, which is the largest oil-producing company in the non-Communist world. The Saudi Government acquired complete control of Aramco in 1980.

The deal would give Saudi Arabia a much more secure market for up to 600,000 barrels of its oil and would give them the potential to earn more money from refined products. This arrangement comes at a time when the Saudis are especially eager to increase their earnings. One expert on the Saudi economy, Eliyahu Kanofsky, of Tel Aviv University, said the Saudi Government has run budget deficits for the last five years.

Texaco maintained that there was no link between the timing of the announcement and its showdown today

The deal may intensify the debate on U.S. energy security.

with Mr. Icahn. A spokeswoman, Anita Larsen, said the company, which said in January that it would sell $5 billion worth of assets, had been negotiating for months and reached an agreement on Wednesday.

The asset sale was part of Texaco's plan to emerge from bankruptcy proceedings earlier this year. It had sought protection from its creditors after it lost a $10 billion suit brought by the Pennzoil Company, which accused Texaco of illegally interfering with Pennzoil's agreement to merge with the Getty Oil Company. Texaco reached a $3 billion settlement with Pennzoil in December.

Reached yesterday before he was scheduled to fly to Tulsa, Okla., for Texaco's annual meeting, Mr. Icahn said in a telephone interview that "anything good for the company is good for me. I'm thrilled about it."

Mr. Icahn, who currently owns 14.8 percent of Texaco's shares, said the Saudi deal would make his proposed acquisition easier to finance.

But Mr. Icahn said the agreement still did not demonstrate that the company was carrying out a restructuring that was good for shareholders. "They're giving you very little, and keeping it themselves," Mr. Icahn said.

In addition to the refineries, the assets involved in the deal include 49 oil terminals, 1,450 Texaco-owned or leased service stations and more than 10,000 other stations that carry the Texaco brand. The deal would give Saudi Arabia assured outlets for an amount of oil that would represent about 8.5 percent of American oil imports.

Saudi Arabia's output in May was about 4.4 million barrels a day, not counting the Neutral Zone, according to the Petroleum Finance Company of Washington, D.C. OPEC has set a production ceiling of 18.5 million barrels a day for its members, but they are exceeding that limit.

Total American imports were running at 7.1 million barrels a day in May, according to the American Petroleum Institute. While the deal would not necessarily cause the United States to increase its imports, it could increase the amount imported from Saudi Arabia.

Low-Profile Investment

Because it is a joint venture, the Saudis would be entering a market foreign to them, but with a partner versed in the engineering, management and political skills needed for operation here. In addition, it is a low-profile investment. In contrast, Saudi Arabia's neighbor in the Gulf, Kuwait, now markets gasoline in a chain of gas stations it owns in Western Europe under the name "Q 8," a pun on the country's name.

The Texaco-Saudi Arabia partnership, to be called Artex (for Arabian Texaco), will buy oil at the world market price, said Thomas Q. Schultz, the president of Saudi Refining Inc., the Aramco unit that handled the deal.

According to a joint announcement, the deal provides that Saudi Arabia will supply half the working capital and three-quarters of the initial oil inventory. Texaco said that by sharing inventory and working capital, it "expects to achieve approximately $2 billion in cash benefits and savings."

Icahn to Get New York Vote

New York City's Comptroller, Harrison J. Goldin, said yesterday that he had decided to vote the roughly 250,000 Texaco shares in the city pension funds for the dissident directors slate supported by the financier Carl C. Icahn.

The New York City Retirement System manages the pensions of the firefighters, police, teachers and other city employees. Together, their shares in Texaco Inc. represent roughly a tenth of a percent of the 243 million outstanding shares.

"They do not all own Texaco stock, but those that do will be voting for the Icahn slate," Mr. Goldin said.

He said he had received unanimous counsel from his advisers to cast his votes against the incumbent management.

He added that Texaco's chairman, Alfred C. DeCrane, had conceded that "it would be some time before this management would be able to realize that price."

Oil Exporters Enter Consumer Nations

Oil-producing nations have been buying refineries and gas stations in the importing countries. This is part of a worldwide trend of the integration of oil production, refining and marketing into single, multifunction companies, as was the case when Texaco and similar companies owned the wells in the Middle East.

Year	What They Bought	Bought From
KUWAIT PETROLEUM COMPANY*		
1981	Santa Fe International	Shareholders
1983–1984	Refining and marketing in Holland, Belguim, Luxembourg, Denmark and Italy	Gulf
1986	Marketing companies in Britain	Hays Group
1987	Distribution and marketing system in Britain	Ultramar; Nafta
1987	Distribution system in Denmark	BP
1988	Lubes plant and distribution system in Italy	Montedison
PETROLEOS DE VENEZUELA		
1983	50 percent of German refinery complex in joint venture with Veba Oil Company	Veba
1985	Lease of Curaçao refinery (formerly Shell refinery)	Southland
1986	50 percent of Citgo (Lake Charles refinery complex and extensive distribution and marketing system)	Southland
1986	Ruhr Oel, joint venture with Veba, expaned to two other refineries, pipelines, and petrochemicals comlex	Southland
1986	50 percent of Nynas (shares in four specialty refineries in Sweden and Belgium)	Axel Johnson
1987	50 percent of Champlin Refining Company (Corpus Cristi refinery complex plus distribution system)	Union Pacific
STATOIL (NORWAY)		
1976–1980	Norsk Olje (with partners)	BP
1985	Marketing and distribution in Sweden	Exxon
1986	Marketing and refining in Denmark	Exxon
PEMEX (MEXICO)		
1979	Petronor (partial interest) in Spain	Petronor
LIBYA		
1983	Refining and marketing in Italy	Amoco
1987	Marketing and distribution in Italy	Texaco/Fintermica

*Does not include Kuwait's 22 percent stake in the stock of British Petroleum.

Source: Cambridge Energy Research Associates

Negotiations began in September. Texaco management complained this spring that its efforts to sell a share in the refineries were being hindered by Mr. Icahn, because potential partners were leery of striking a deal with a management that could be replaced. Mr. Schultz, however, said, "nobody on our team has had made any such statement."

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with a guarantee from Phillips, to buy shares of common stock from the company, a Phillips spokesman, Dan Harrison, said. The proceeds from the sale of the stock will be used to retire existing company debt, Mr. Harrison said.

the project's cost of the expected completion date. Hilton, which generally owns hotels in joint ventures with other parties, owns and operates three hotel-casinos in Nevada, all of which were acquisitions of existing properties.

Stake in Pennwalt Pushes Stock Up

By Reuters

The Pennwalt Corporation, a Philadelphia chemical and drug company, could fetch as much as $1.04 billion in a takeover, but some analysts ex-

cent of Borg-Warner and was trying to buy the rest.

James F. Bere, chairman and chief executive of Borg-Warner, said the $2.3 billion from this deal, along with the proceeds from other asset sales and record earnings last year, "moves us closer to our considerable debt bu said the money would al

• **Comfed Bancorp Inc.,** Lo Mass., said it had accepted the r nation of James G. Baldini as p dent of its Comfed Mortgage Co.

• **Dow Chemical Co.,** Midland, elected as a director Wi owner of All

COMPANY BRIEFS

Saudi Arabia, Texaco Disclose Gasoline Pact

Kingdom to Pay $1.2 Billion, Become a Major Retailer Through Firm's Stations

By Thomas Petzinger Jr.
Staff Reporter of The Wall Street Journal

Saudi Arabia agreed to pay about $1.2 billion to **Texaco** Inc. in a transaction that would make that nation one of the largest gasoline retailers in the Eastern U.S.

In a long-expected announcement, the White Plains, N.Y.-based oil concern and Saudi Arabia said the kingdom will acquire 50% ownership of three Texaco refineries—including one of the largest such facilities in the world—as well as marketing access to 11,450 gasoline stations.

The Saudi-Texaco alliance, if completed, would represent by far the biggest move yet by a member of the Organization of Petroleum Exporting Countries to the gasoline pump.

"The size of this deal is staggering," said Antonio Szabo of Bonner & Moore, Houston, an industry consulting concern. "Both in the magnitude and complexity of the assets, it is absolutely unprecedented."

The transaction would give the crude-rich Saudis a secure market and crude-short Texaco a secure supply—as well as, perhaps, a few more votes in a proxy fight that is due to reach a climax at Texaco's board meeting in Tulsa, Okla., today.

"I'd call it an election-eve event," said an adviser to Carl Icahn, Texaco's largest holder, who is leading a fight to obtain five board seats at the meeting.

In White Plains, a Texaco spokesman pointed out that negotiations with the Saudis had been under way for months and said the timing of the announcement was coincidental.

It couldn't be learned whether Texaco's letter of intent gives the Saudis a way out if Texaco's management loses control of the company to Mr. Icahn.

Mr. Icahn said he was delighted that the proposed asset sale might facilitate his $60-a-share takeover offer for the company. "I'm in favor of anything good for the company," Mr. Icahn said. "If they do a good Saudi deal, it makes my financing easier."

Benefits to Both Parties

And outwardly, at least, the proposed accord seems to be a good one for Texaco as well as the Saudis. In exchange for the specified Texaco assets in 23 states—those east of the Mississippi River plus Texas, Louisiana and parts of Oklahoma—the kingdom will pay $800 million and will contribute about 22.5 million barrels of crude oil currently valued at about $400 million.

"It's really a very fair deal," Mr. Szabo of Bonner & Moore said. "The dollar value looks very equitable."

Texaco also figured that by having a partner to share the working capital and other expenses, it would realize an additional one-time savings of about $800 million, raising the value of the transaction for Texaco to $2 billion.

The transaction, which Texaco expects to complete by year's end, could have a wider significance for world oil markets—partly by making them more volatile than ever. The joint venture would have the right to buy as much as 600,000 barrels of oil a day—practically the entire capacity of the three refineries—from Saudi Arabia at what the parties called "prevailing market prices."

Texaco wouldn't elaborate. But Thomas Q. Shultz, president of Saudi Refining Inc., Texaco's intended joint-venture partner, said the venture would designate a "marker" crude oil, such as Alaska North Slope, North Sea Brent or Dubai crudes, and would adjust the price it pays Saudi Arabia in line with the fluctuations in the price of that "marker" crude.

Fluctuating Prices

This means that nearly 15% of Saudi Arabia's current production of about four million barrels a day would be traded on the basis of rapidly fluctuating market prices rather than under the "fixed" OPEC pricing system.

The proposed arrangement could only benefit consumers, many industry specialists said. Texaco controls about 8% of the gasoline market in most of the 23 states included in the arrangement, and the Saudis can be expected to take whatever steps are necessary to defend that share.

"The consumer will see lower prices," said Norman Higby, a Menlo Park, Calif., energy forecaster who has been predicting such a Saudi-Texaco accord for nearly two years.

In fact, other major oil companies and oil-exporting nations may have no choice but to follow suit. "Chevron is next," said Mr. Higby, who identified Venezuela and Mexico as possible joint-venture partners for that oil concern. Daniel Yergin, president of Cambridge Energy Research Associates, said, "This will shake the dust from the boots of other exporters—and a lot of companies."

But Texaco and the Saudis are unlikely to touch off major gasoline price wars throughout the East—a move that would almost certainly invite antitrust scrutiny. "That issue is so enormous that both parties in this transaction will be very sensitive to the legal and commercial pitfalls," Mr. Yergin said.

The months of intensive talks on the joint venture followed at least three years of discreet contact between Texaco and Saudi officials, according to a consultant to the Saudis. For about 50 years, Texaco has been a member of the Arabian American Oil Co. consortium, along with **Exxon** Corp., **Mobil** Corp. and Chevron—companies whose demands for Saudi crude may now come second to Texaco's.

Only Chevron had a comment on the Texaco-Saudi announcement. "Chevron has had a mutually beneficial 50-year relationship with the Saudis, and we wouldn't anticipate this development having any impact on this relationship one way or the other," a spokesman said.

Assets involved in the proposed sale include the Texaco trademark on gasoline, home heating oil and diesel fuel in the East. In addition, the joint venture would acquire 1,540 service stations owned or leased by Texaco and a contract or other arrangement to supply about 10,000 other stations.

The refineries that propose to contribute to the venture are Texaco's huge Port Arthur, Texas, plant; its refinery at Convent, La., which has recently undergone a major upgrading; and its plant at Delaware City, Del., which was acquired along with the rest of Getty Oil Co. in 1984. No significant layoffs among the plants' 4,500 workers are envisioned.

The Delaware City plant was built by J. Paul Getty to process crude oil from the so-called Neutral Zone, a strip of land administered by Saudi Arabia and Kuwait. Mr. Getty acquired rights to Neutral Zone production and built the plant to try to offset the strength of Texaco and the other companies in the Arabian American consortium.

—Allanna Sullivan contributed to this article

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